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PREFACE TO THE THIRD EDITION

In this edition the book has been thoroughly revised with a view to incorporate war-time changes in our banking structure. Various statistics have also been brought upto date. It is hoped that our readers will extend their patronage to this edition as well as they extended to previous editions.

K. N. G.

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CONTENTS

Book I—Principles of Banking

CHAP.	PAGES
I. Introductory Survey	1
II. English Banking History and Development...	9
III. Kinds of Banks	17
IV. Functions and Services of a Commercial Bank	27
V. Banking Operations of a Commercial Bank...	39
VI. Central Banking	61
VII. " " —(continued)	82
VIII. Credit and Credit Instruments	97
IX. Relations of a Banker to His Customer ...	123
X. Banker's Security for Advances	149
XI. Bankers' Clearing House	162

Book II—Banking in India

XII. Historical Review	168
XIII. Indigenous System of Banking	186
XIV. Agricultural Finance	215
XV. Industrial Finance	241
XVI. Commercial Banks	265
XVII. Imperial Bank of India	299
XVIII. Exchange Banks	320
XIX. Reserve Bank of India... ..	332
XX. Defects and Remedies	361

APPENDICES

A Definition of a Banking Company	375
B Draft Scheme for the Linking of Indigenous Bankers	377
C Proposals for an Indian Bank Act	379

CHAPTER I

INTRODUCTORY SURVEY

The subject of Banking which we propose to deal with in this volume is but a department of the great Science of Economics. But, it has assumed such vast importance in the present day economic organisation of the world that it claims our special attention. In fact, the industrial and commercial development of a country depends, these days, largely upon the efficiency of its banking organisation.

MEANING

The word banking has been used to denote a certain kind of trading in money. It consists of principally the exchanging of money; the lending of money; the depositing of money; and the transmitting of money. In most countries, these activities seem to have taken their rise in this very order. In our own country, during Vedic period, indigenous bankers exchanged the coins of one sovereign for that of another and also those of gold for silver and *vice versa*. Simultaneously, they lent money to the needy both on the basis of interest and without it. Later on, perhaps much before the time of Manu, they had begun receiving deposits and finally undertaking remittance business. In England also, Edward III appointed in 1341 Royal exchangers with the exclusive privilege of giving newly coined gold nobles, half nobles and farthing nobles for silver currency, and *vice versa* at fixed rates which yielded them a profit of $1\frac{1}{2}$ per cent on every transaction. They were also empowered to give the current coins of the kingdom in exchange for foreign coins and *vice versa* according to a table which hung up in their office for public inspection. In the profits made by these operations the king too had a certain share. There is a record of the lending business as well in that country even in the days of Edward, the Confessor. The Jews and the Lombards, gradually became the principal money-lenders in the kingdom; and when they were driven out, goldsmith bankers had begun undertaking this business. Deposit busi-

ness began there only after 1640. Till then, people deposited their money with the Exchequer, but in this year Charles I passed a confiscation order. This was no doubt withdrawn later on, but the prestige of Royal honour having gone, money began to be deposited with the goldsmiths, instead of with the Exchequer. Transmission of money was, first of all, effected by sending the coins through messengers. Later on, it was accomplished by bills of exchange which began to be purchased and sold by merchants and finally bankers. At present, banking denotes all these activities and certain others which we shall deal subsequently.

ORIGIN

From the above discussion, it is obvious that banking business of one sort or the other was carried on in India even in ancient times. The French writer Revilpout held that there were banks and bank notes in Babylon in 600 B.C. The word seems to have been, however, used first of all in Italy in the middle ages with the foundation of the Bank of Venice. There were at this time a number of city states in that country and they fought with one another. It so happened that in 1171, the authorities of the State of Venice were involved in a serious financial difficulty due to their being engaged in a deadly war. The Great Council, not finding any other remedy, ordered a forced loan of one per cent of the property of every citizen at an interest of 5 per cent per annum. Commissioners were appointed to manage the payment of the interest to the fund-holders and the transfer of the stock. The most usual name for such a loan in Italian language is *moute* meaning a joint stock fund. At this period the Germans were the masters of a great part of Italy, and hence its German equivalent *banck* came to be used as well in that country. By and by, it was italianised into *banco*, frenchised into *banke* and finally anglicised into *bank*. English writers even in the seventeenth century used the word *banke* as is evident from the writings of Benbrigge who in 1646 mentioned of "The Three Bankes of Venice" meaning thereby the three public loans of that place. Later on, there appeared several banks in different cities of Italy under the same circumstances. We had the Bank of Milan, the Bank of Florence, the Bank of St. George at Genoa, etc.

In the time of Cromwell, proposals were made in England also to found a bank exactly under the same conditions but as we shall see in the next chapter they did not materialise before 1694, in which year the Bank of England was formed in a similar manner, of a company of persons who advanced a sum of money to Government, and received an annuity in exchange for it.

There is supposed to be another derivation of the word as well. According to this, it has been suggested that it comes from the Italian word *banco* meaning a bench or table because the money-changers kept their money-heaped on benches and tables. But Macleod, in his book *Theory and Practice of Banking*, ridicules the idea. He says therein. "Nevertheless, there can be no possible doubt that this derivation is a pure delusion, for the money-changers, as such were never called *benchieri* in the Middle Ages". He also quotes several authorities in his support. Finally, he remarks, "There is no doubt whatever that these learned authors are perfectly correct and the true original meaning of a *banco* is a heap, or mound and this word was metaphorically applied to signify a common fund, or joint stock, formed by the contribution of a multitude of persons".

DEFINITION

In spite of the many definitions¹ of the word bank or banker, it is rather curious that none is so satisfactory

¹Definitions by eminent authorities on the subject:—

(1) The word bank expresses the business which consists in effecting on account of others receipts and payments, buying and selling either money of gold and silver or letters of exchange and drafts, public securities and shares in industrial enterprises—in a word—all the obligations whose creation has resulted from the use of credit on the part of states and societies and individuals—*Gautier*.

(2) No one and nobody corporate and otherwise can be a banker who does not (i) take deposit accounts, (ii) take current accounts, (iii) issue and pay cheques drawn upon himself, (iv) collect cheques crossed and uncrossed for his customers—and, it might be said that even if all the above functions are performed

as to be universally accepted for the obvious reason that diverse activities come within the orbit of the business of banking. In most countries, it is carried on under duly codified legislation, and there is no doubt regarding the legal concept of the word, though all persons and institutions doing this business do not come under the grip. In our own country, the definition of a banking company has been given in Section 277² of the Indian Companies Act, 1936, but as has been pointed out by the authorities of the Reserve Bank of India, there are a large number of non-scheduled banks operating in British India which claim that they are not banks within the meaning of this Section and hence do not submit the prescribed³ cash reserve returns. It was on this account that the following

by a person or body corporate, he or it may not be a banker or bank unless he fulfils the following conditions: (i) banking is his or its known occupation, (ii) he or it must profess to be a banker or bank and the public take him or it as such, (iii) has an intention of earning by so doing, (iv) this business is not subsidiary—*John Paget*.

(3) A banker or bank is a person, firm or company, having a place of business where credits are opened by the deposit or collection of money or currency subject to be paid or remitted upon draft, cheque or order or where money is advanced or loaned on stocks, bonds, bullion and bills of exchange, and promissory notes are received for discount and sale.—*Findlay Shirras*.

(4) Bank is an establishment which makes to individuals such advances of money or other means of payment as may be required and safely made and to which individuals entrust money or means of payment when not required by them for use.—*Kinley*.

(5) A banker is one who, in the ordinary course of his business, honours cheques drawn upon him by persons from and for whom he receives money on current account.—*Dr. H. L. Hart*.

²See Appendix.

³According to the amendment of the Indian Companies Act, 1936 since February, 1938, the Registrars of the Joint Stock Companies send to the Reserve Bank of India a copy of the cash-reserve return received by them from non-scheduled banks in pursuance of Sec. 277L of the Act under reference.

proviso was added to the section referred to above in 1942 :—"Provided that any company which uses as part of its name the word 'bank' or 'banking' shall be deemed to be a banking company irrespective of whether its principal business is the acceptance of deposit on current account or otherwise. In the United States of America, a bank is a corporation holding a bank charter either from the Federal Government or a State Government. Its functions have been well-defined and the conditions under which they can be exercised have been laid down by the Law. Inspectors have been appointed by the Government to see that these conditions are strictly observed. But there are still many institutions which carry on banking activities of one sort or the other and do not come under the pervasion of the law. In England, on the other hand, no such legal definition exists. Gilbert quotes in his book from a speech delivered in the House of Commons in 1745 the following: "What is it that we call a banker? There is in this city a company or corporation called goldsmiths, and most of those called bankers are of that corporation; but so far as I know there is not a company or corporation called bankers, nor has the business any description either by common law or by statute. By custom we call a man a banker who has an open shop with proper counters, servants, and books for receiving other peoples' money in order to keep it safe and return it upon demand; and when any man has opened such a shop, we call him a banker without enquiring whether any man has given him money to keep." The position has since then, much changed. Goldsmith bankers have ceased to exist. Companies and corporations calling themselves banks have been formed. But it is true even to this day that the business has no description either by common law or by statute. Walter Leaf says, "There is, however, a fairly clear general notion in England at least at the present time of what is meant by a bank.....But it is certain that if a definition of a bank were required to-day, it would be a different definition from any that would be accepted in another country, or that would have been accepted in England even a hundred years ago". The definition as laid down by him is "A bank is a person or corporation which holds itself out to receive from the public,

deposits payable on demand by cheque". Now, as he himself has remarked, this does not express more than one part of the business of a bank. But in fact, this being a fundamental part of the operation of a bank in England and other countries including India whose banking structure has been formed on the basis of that of England, it can be accepted of the banks of these places at least for the present. But in other countries specially of the continent of Europe where the use of cheques is not so developed, a definition would rather be sought from some other operation. French writers in their definition of the word bank lay greater stress upon the discounting of bills and the giving of monetary credits.

There is one very important point which must never be lost sight of and it is that the modern banks do not discount bills and give monetary credits, only to the extent of the species received by way of deposits. In fact, they do not act merely as intermediaries between borrowers and lenders as is suggested by certain writers⁴ and any definition which goes to convey this idea can be nothing but far from satisfactory. The goldsmiths of London who were the earliest bankers of England, had found even in the earliest stage of their development that they could lend several times the cash actually received by them from their customers. This is exactly what the business of banking consists in, though some writers of greatest influence do not seem to have understood it. They were against the creation of a credit larger than the species held by the banks. The Banks of Venice, Amsterdam and Hamburg issued papers within this limit, and Mill said that substitution of paper for metallic currency was a national gain but any further increase of paper beyond this was but a form of robbery. A clear exposition of the practice of banking shows that this is the usual practice followed these days and we

⁴A banker is a dealer in capital or more properly a dealer in money. *He is an intermediate party between the borrower and the lender.* He borrows of one party and lends to another; and the difference between the terms at which he borrows and those at which he lends, forms the source of his profit".—*Gilbart*.

have got robbery and robbers rampant everywhere. It is said that the secret of banking lies in multiplying the available resources. "The bankers' brain and others' money" explains the whole situation.

The way is not smooth enough even now. There are some more erroneous ideas which must also be clearly understood. First of all, it must be said that money-lending, though a principal function of a banker, does not in itself constitute banking, and money lenders as such are not bankers. To be so, they must also receive deposits as receiving of deposits and lending of money both taken together go to make up banking business. Then, creation of credit which is an important function of a banker does not necessarily mean that he must also have note-issuing power. It was in reality this erroneous belief that checked the growth of joint banking for long in England. As a clause in the Bank of England Charter Act of 1708 forbade the issue of notes to a body consisting of more than 6 persons except that of the Bank of England, and it was believed that no bank could perform essential banking functions without having this power, no joint stock bank was established in that country. It was only after 1833, when by a clause in the Bank of England Charter Act of that year, it was cleared that there was no restriction on the business of banking, provided notes were not issued, that the joint stock banks were started in London. They, then, developed what is known as deposit banking and cheque habit which had already been introduced by private bankers, and the cheque currency is today much more important than the note currency. The establishment of joint stock banks in places outside London had already been taking place since 1826, when note-issuing business was allowed to them provided they did not exercise this function in London and within an area of the radius of 65 miles thereof.

CONCLUSION

In conclusion we may say that the word *banking* was first used sometimes in the twelfth century, though the business had been in existence in one form or the other even in hoary antiquities. The first meaning assigned to it was

the creation of a joint stock fund. Receiving of deposits and lending of money which constitutes one of the principal functions of a banker these days was developed by the goldsmiths of London later on. But they did not act only as intermediaries between depositors and borrowers, as they granted credit of a much larger amount than what they actually received in cash. Cheque currency, though introduced by the goldsmith bankers, was developed by the joint stock banks of London to counteract the drawback due to the prohibition of note-issue business to them. It has since assumed so much importance that a definition of the word *bank* cannot be regarded as satisfactory if it does not lay emphasis on this form of currency. But this is not required of its definition everywhere. It is so only as far as England and countries with their banking system based on that of it are concerned. From this, it is clear that any definition of the word *bank* cannot be claimed to be generally applicable to the banking system of all the countries and of all times.

TEST QUESTIONS

1. What is the meaning of the word bank? Does it signify only the receiving and lending activities of the banks?
2. What do you think is the origin of the word bank? Does it coincide with the beginnings of the business of banking?
3. Give a definition of the word bank. What are the difficulties which come in your way in framing a suitable definition?
4. Comment on the following.
 - (a) "A money-lender is not a 'banker.'"
 - (b) "A banker is an intermediate party between the borrower and the lender."
 - (c) "Banking business cannot be carried on without a power to issue notes."
 - (d) "The sole business of a bank is to exchange specie for paper and paper for specie."

CHAPTER II ENGLISH BANKING HISTORY AND DEVELOPMENT

As the banking system of most of the countries of the world and specially of India is based on the English Banking system it is very necessary that we must go through its history and development.

EARLY BEGINNINGS

The seed of modern banking was planted in England by the famous bankers of Lombardy when they settled in London at the place now known as Lombardy Street. They could not remain there for long due to the ever-increasing restrictions which were placed on their activities by the successive monarchs of the country. But as has been said by Davar¹ "The Lombards left England, yet the legacy of trade including banking they left behind, enriched the country". Banking in the modern sense of the word began there only after 1640 when goldsmiths had begun receiving deposits from the public due to the circumstances referred to in the previous chapter. They issued receipts promising to pay the value on demand, and utilised the deposits in various profitable ways. The money coined at that time was of unequal weight, and they having acuter perceptions with respect to the value of bullion in the coin than the public; naturally melted the heaviest of them for export. Besides, they lent it out at interest, and discounted the trade bills of the merchants. Their resources soon brought them a richer clientele. The Government of Cromwell and of later monarchs approached them for regular accommodation. The business being lucrative, force of competition amongst themselves compelled them to offer higher interest with a view to attract more and more of deposits. Gradually, the receipts issued by them began to circulate as bank notes, and it was only a matter of time to issue them in convenient denominations. Goldsmith bankers also kept pass-books which were copied out everyday from their

¹See Law and Practice of Banking by S. R. Davar, page 2.

ledgers and could be occasionally called for comparison by the depositors who drew drafts on their basis to make payment to their creditors. In course of time, these drafts came to be printed for fixed amounts in blank and handed over to the depositors for signature and delivery to their creditors in payment of debt. They may thus be regarded as parents of the blank cheque forms and cheque-books with which we are so familiar these days. The practice followed by goldsmiths was gradually adopted by the rich men of the neighbourhood—very often the local brewers or cloth merchants whose names stood high on the country-market. They, however, did not encourage the use of cheques so much as that of the notes. In fact, the London goldsmiths first and the London joint stock banks afterwards laid greater stress upon the use of the cheques than upon that of the notes because of the special circumstances under which they had been placed.

FORMATION OF THE BANK OF ENGLAND

A mention was made in the first chapter of the fact that though the proposals for the foundation of a bank of the Italian type had been made in England as early as in the days of Cromwell, they could not materialise before the year 1694. Now, we shall look to the circumstances which made it possible at this time. The accession of William III to the throne of England introduced the system of parliamentary government and control over the national finances. This went a good deal forward to restore that confidence in the integrity of the state which had been lost because of the unscrupulous deeds of the misguided kings in the past and of which confiscation order issued by Charles I is only an instance. The demand of the Ministry for money was very great, and public opinion was in favour of meeting it. The result of all this was that the scheme of William Patterson for raising a loan of £1,200,000 for the state by means of a public subscription was commended by the people and the bill embodying the provisions for the establishment of the Bank of England was passed and received the Royal assent on the 25th of April, 1694. The whole stock was taken up

within 10 days of the notification, and the subscribers formed a body corporate. This body—Bank of England—lent the whole sum to the Government at 8 per cent per annum and to this was also added £1,000 a year for the expenses of management. It was also empowered to issue notes to this extent.

RESTRICTION OF NOTE-ISSUE BUSINESS TO OTHER SIMILAR INSTITUTIONS AND ITS EFFECTS

The success of the Bank of England which was promoted when the Whigs were in power induced their rival Tories to make a similar experiment and they got a measure passed for establishing a land bank. The project proved a total failure, but to prevent its recurrence, the Whigs in 1708 provided the following in the Bank of England Charter Act of that year: "During the continuance of said corporation of the Governor and Company of the Bank of England, it shall not be lawful for anybody politic or corporate whatsoever, created or to be created (other than the said Governor and the Company of the Bank of England), or for any persons whatsoever, united or to be united in covenants or partnership exceeding the number of six in that part of Great Britain called England to borrow, owe or take up any sum or sums of money on their bills or notes, payable at demand or at a less time than six months from the borrowing thereof". This had the effect of conferring a monopoly of the issue of notes in London² and its neighbourhood to the Bank of England in practice though not legally. No doubt, these notes were not declared legal tender till 1833, but as up to that time they enjoyed the privilege of being accepted in payment of taxes and Government dues, they had the prestige which favoured their larger circulation than that of those issued by the London goldsmiths. Hence, they laid greater stress upon the development of the habit of the use of cheque currency and this was also done by the London Joint Stock banks when they were established there after 1833 with an explicit prohibition of the note-issue business to them in London and an area within a radius of 65 miles thereof. As the means of

²At that time Bank of England had its office only in London.

transport and communication had not developed, the Bank of England kept its office only in London upto 1825, so that its notes did not get into circulation in the country-side in such a way as to compete seriously with the notes issued by the private country bankers. These bankers, therefore, did not lay greater stress upon the use of the cheque currency.

MODIFICATION OF THE ABOVE RESTRICTION

The Act of 1826 allowed the establishment of joint stock banks with the privilege of note-issue business provided they had no office in London or an area within a radius of 65 miles of it and that they did not issue their notes in any place within this area. This actually brought about the establishment of some important banks on the country-side.

BANK OF ENGLAND CHARTER ACT OF 1844

Next, we come to the Bank of England Charter Act of 1844 which is a landmark in the history and development of English banking. For some years preceding the passing of this Act, the condition of the note-issue business in England had caused very general dissatisfaction. Crises, after crises had occurred and one private banker after another had failed with the result that public opinion had been aroused against what was supposed to discourage joint stock banking in the country. We have just seen that the establishment of the joint stock banks outside London and within an area of a radius of 65 miles thereof with the power of note-issue business, and inside London and this area without this power had been allowed in 1826 and 1833 respectively. This was, no doubt, due to this very fact. Bank of England had also been advised and authorised for the same reason to open its branches in some of the principal provincial towns, and to issue notes from there. The towns which were first selected were Gloucester, Manchester and Swansea. The sole aim of all these measures was to reduce the note-issues of the weak private bankers. The Act of 1844, however, contained specific provisions to this effect. There were at this time two schools of thought with regard to the regulation of

note-issues, *e.g.*, Currency and Banking. The former held that the note-issues ought to be always worth the same amount as the gold in place of which it was issued, while the latter held that the only care necessary was that the note-issue did not exceed the legitimate trade demands as opposed to speculative demands. The Bank of England Charter Act was a victory for the upholders of the Currency Theory. Its main provisions were as follows :—

(1) The Bank could issue notes to the extent of £14 millions upon securities set apart for that purpose of which the debt of £11,015,100³ due from the Government to it was to form a part.

(2) The amount of notes issued above £14 millions was to be only against gold coins or gold or silver bullion⁴—the amount of silver bullion not exceeding at any time to one-fourth of the amount of gold coins and bullion.

(3) After the passing of the Act, none was allowed to issue notes except such⁵ as were issuing their own notes on May 6, 1844.

(4) Every banker (other than the Bank of England) claiming the right to issue notes was required to send to the Commissioner of Stamps a return of the average amount⁶ of such issues for the 12 weeks preceding April 27, 1844, and none was allowed in future to exceed this amount on an average of four weeks.

(5) If any such banker ceased to issue notes either due to bankruptcy or due to the violation of the above provision,

³The Bank had been advancing huge amounts to the Government since its establishment. This figure had been reached by this time gradually from the original figure of £1,200,000 in 1694.

⁴In 1928, the Bank was allowed to include among the securities held against the fiduciary issue silver coins not exceeding £5½ millions in amount. Since then, silver coins or bullion cannot form part of the metallic reserve.

⁵Their number in England and Wales was at that time 279.

⁶The average amount was £8,631,647.

he could not resume the issue.

(6) In case any banker ceased to issue notes, Bank of England could increase⁷ the amount of the securities in the Issue Department to the extent of two-thirds of such lapsed issue and issue notes against these.

(7) The Bank was to pay £180,000 a year to the Government for its privileges and exemption from stamp duty on its notes. All profits on the issue of notes beyond £11 millions were to go to the Government.

The effect of the provisions laid down in the above Act was to extinguish gradually the note issuing power of the private bankers and other joint stock banks, though the process took a much longer time than was expected even by the supporters of the measure—the last of these having been lapsed in 1921 with the amalgamation of the business of Messrs. Fox Fowler & Co. with that of the Lloyds Bank Limited. The use of cheque currency was developed to a prodigious extent.

ABSORPTION OF PRIVATE BANKERS BY JOINT STOCK BANKS AND THEIR AMALGAMATION

At the time the Bank of England Charter Act was passed there were following classes of bankers and banks carrying on banking business of one or the other type in the country :—

(1) Bank of England with its Head Office in London and branches in important provincial towns.

(2) London goldsmiths known as the private bankers of London with limited power to issue notes but mostly encouraging the use of cheque currency.

(3) London joint stock banks without any power of note-issue but encouraging the use of cheque currency like the private bankers mentioned in (2).

(4) Private country bankers with limited power to issue notes.

⁷The amount of fiduciary issue because of this provision went on increasing till it reached the figure of £19,750,000 in 1921 after the lapse of the note-issuing power of the last private banking firm.

(4) Provincial joint stock banks with limited power to issue notes like the private country bankers mentioned in (4).

For some time, all these bankers and banks existed together, but later on there arose between them a tendency towards concentration by absorption and amalgamation and the spread of branch banking, as is evident from the figures given by Jas. Dick in the paper he read before the Institute of Bankers. These are available in Sykes' Banking and may be tabulated here also.

Year	No. of Banks	No. of offices	Persons served by one office
1883	317	2,382	11,315
1891	61	3,231	8,915
1901	171	4,872	6,667
1911	99	6,413	5,630
1921	40	8,022	4,722

These figures are for England and Wales and exclude the London offices of the foreign Colonial and other overseas banks but include those of the Scottish banks. At present, there are not more than a dozen of these banks in this part of the kingdom.

For the causes leading to this tendency we may say again on the authority of Sykes that London joint stock banks absorbed private country bankers with a view to have branches on the country-side and provincial joint stock banks in their turn absorbed the London private bankers in order to provide for offices in that town. Larger joint stock banks amalgamated amongst themselves with a view to increase their branches and eliminate competition.

Fear was expressed that these absorptions and amalgamations may result in concentrating the monopoly of banking within the power of a limited number of banks, and that the public might suffer as a result, but there has been so far nothing to justify it. Quite contrary to this, it has led to a greater uniformity of practice which has in

its turn resulted in sounder methods of banking and hence to greater security. Besides, they have, several times, due to their being in a comparatively small number, been able to attain that decisive and concerted action which is so very necessary to save the people from grave financial peril in times of emergency.

TEST QUESTIONS

1. Give a short description of the business of goldsmith bankers. What led them to lay greater stress on cheque currency than on note currency?

2. Describe the circumstances under which Bank of England was formed. How did it get the monopoly of note-issue business in London?

3. When and how was the Bank of England deprived of the monopoly of joint stock banking in London?

4. Under what circumstances Bank of England Charter Act of 1844 was passed? State its principal clauses and their effects.

5. What different classes of banks and bankers were in existence in England at the time of the passing of the Bank Act of 1844? How did they fare later on?

CHAPTER III

KINDS OF BANKS

The modern tendency towards specialisation in every department of economic life has manifested itself in banking business also, and we have got different kinds of banks, each serving a definite economic end. But it does not mean that specialisation has been carried everywhere to the fullest extent and that there is no overlapping of business. There are institutions which combine banking with trading or one kind of banking with another.

1. COMMERCIAL BANKS

The most important kind of banks is the commercial bank. In fact, when the word bank is used without any epithet, it conveys the idea of this kind of bank. Besides, it is the most common kind of bank with which almost everyone of us comes so often in contact. As its very epithet suggests this bank has its connections with the commercial class of people. It collects their floating capital and finances the temporary needs of commercial transactions. Its deposits are purely demand obligations and hence it is by nature quite incompetent to offer any long-term accommodation. It has, rather, been a rule amongst this class of banks not to grant permanent loan and provide capital for investment purposes. Nor does it furnish the whole fixed capital for trading purposes but it supplies as much as is occasionally needed for carrying on business or making investments in it. It has to distinguish between a genuine borrower and speculative investor as well. A commercial bank has to encourage the former and discourage the latter. It can, on no account, be a risk-bearer, willing to take chances. Its depositors have a faith in it, and it has to prove worthy of it by answering all of their calls—so much so that a single failure is enough to be a serious death-blow to it. But it may be said here that its loaning capacity is not restricted to the amount of deposits received by it. A bank manufactures credit.

Most of its loans are not paid in cash. They are usually withdrawable by cheques as are also its actual deposit receipts. Experience has shown to these banks that all withdrawals are not made at the same time, and while cash is paid at the counter, it is also simultaneously received there. It is also not required to pay all the cheques at its counters. Some are received through other banks, and more often they are counter-balanced by its own rights in connection with the cheques received from its customers on them. From the above, it is quite obvious that it can grant credit several times larger than its actual cash holdings. What should, however, be the percentage of actual cash holdings to the credit is a question whose answer surely cannot be given in very definite words. It depends upon the nature of the community that the bank serves, and that of its investments. In certain cases, it varies also with a variation in the season. Moreover, it may change over a long period of years due to the changes in the banking habits of the population. "Nevertheless every bank manager has in his mind's eye a conventional percentage which it is his endeavour to maintain, knowing that every reduction below that percentage reduces his margin of safety, and every excess above reduces his profits." A commercial bank, over and above, the kind of business specified so far, also performs many functions which will be discussed later on. The only thing that need be mentioned here is that the spheres of business of this kind of bank are not the same everywhere. This may be said of their methods of operation as well. While English banks and specially London banks do not undertake investment business, German and French banks do undertake it. The former also lay greater stress upon the use of cheques while the latter do not.

CENTRAL BANKS

Before the commencement of this century there had been no clearly defined concept of the central banks though a gradual evolution had been taking place in various countries over a long period of years. The temperament and discretion of individual management had till then played the principal part in the decisions and operations of each

one of them. In many of the older countries, one bank had come to assume more and more importance owing to its acquisition of specially the sole or principal right of note-issue and conducting the banking operations of the Government. The first name given to them was not central banks, but banks of issue or national banks. In due course, they acquired other functions and powers and gradually the term central bank began to be used with more or less a standardised meaning. Bank of England is perhaps the first of those institutions which acquired this role, and its history is universally accepted as illustrating the evolution of central banking principles and technique. Incidentally, this was also the first joint stock bank of the country. During the course of the nineteenth century the governments had in various countries either endowed an existing bank with the sole or principal right of note-issue or brought about the establishment of a new bank with this power. There were, however, many countries of the New World, and China and India of the Old World, which were without a central bank even at the beginning of this century. The most important country of the present day, namely, the United States of America remained without one till 1914, when twelve Federal Reserve Banks in different parts of the country with a co-ordinating Federal Reserve Board at Washington were established with a view to fill up the gap. Encouraged with the benefit and assistance rendered by it to the government and the banks of the country during the war and post-war period and following upon the recommendation of the International Financial Conference which was held at Brussels in 1920, the newly created States of Europe and those countries, of both the New and Old World which had no central banks till then, have since established such institutions¹. In fact, modern conditions of banking and commerce necessitate, irrespective of the stage of economic development of a country, a centralised cash reserve and control of currency and credit subject to some form of state supervision and parti-

¹Central Bank of China and the Reserve Bank of India were established in 1928 and 1935 respectively.

cipation. A central bank also offers the best means of communication and co-operation between the banking system of one country and that of another.

EXCHANGE BANKS

The sole business of the exchange banks is to finance foreign trade and bring about the settlement of debts between foreign countries. Their branches are spread all over the globe, and specially in the important trading countries, and as such they require huge funds at their disposal. Exchange business is intricate and requires expert and skilful handling. It is also attendant with great risks, though the introduction of the exchange standard system has reduced them considerably. Prior to this, the exchange rates between gold-using and silver-using countries fluctuated widely and exchange relations between them were of a speculative character. All this made it impossible for the ordinary commercial banks to undertake this business, and hence arose these specialised institutions. They purchase bills from exporters and sell their proceeds to importers. For most of the exports the exporters draw bills on the importers in foreign countries for payment on their maturity, and instead of waiting for the equivalents of their proceeds, they discount them with or sell them to the exchange banks. These in their turn may either keep them till maturity or sell them before it in foreign countries, and specially in the London and New York money markets, where there is always a demand for these. In countries where they have no branches, they have their correspondents and do business through them. They draw their own drafts on their foreign branches and correspondents and those in need of sending money abroad get these issued in favour of those parties to whom they wish to make the payment. They liquidate international indebtedness by exporting or importing precious metals and securities, and this business gives them scope to handle gold and silver bullion and foreign securities. They purchase and sell 'forward exchange' too and thus minimise the difference in exchange rates between different periods, and also protect merchants from losses arising out of exchange fluctuations by bearing the risk. The exchange banks, in

their own turn, cover themselves by reciprocal dealings *e. g.*, selling for purchasing *vice versa*. In other countries, besides the exchange banks, the commercial banks also take up this business, but in India it is not so. There are banks of foreign origin which have an exclusive monopoly of this business.

INDUSTRIAL BANKS

Industrial banks finance and aid the industries other than agriculture. Commercial banks by nature of their liabilities cannot take up this business.² Besides, they lack in specialised staff. Industrial banks, on the other hand, receive funds for long terms and keep an expert staff whose business is to understand the intricacies of the industries they may be called upon to come in contact with. They very often exercise effective control over the industrial companies, financed by them by having their representatives included in their directorates. The first thing that an industrial bank does, when an industrial concern approaches it for recommending its issue of shares or debentures or for direct financial aid, is to investigate fully into and analyse the soundness of the issue, the business of the concern and the prospects of the scheme. Sometimes when the whole amount of the share capital offered for subscription or the minimum subscription as fixed in the Memorandum of Association is not taken up by the public within the prescribed time, it comes to the rescue by taking up the residue upon its own shoulders. In fact, all new issues are underwritten by one or more of these banks from its very inception. They also become advisors to their customers and assist them in selecting the best type of investments. On the other hand, they free the industrialists from a very different task, namely, that of raising its funds. Truly speaking they, on account of their being specialists in this work, have the advantage of possessing a greater skill in advertising and salesmanship of shares and debentures than most of the industrialists. They are financing educators and by scores

² "Greatest problems of banking organisation and control have arisen on account of the confusion of investment and commercial operations." *H. G. Moulton.*

of means create investment habits in the people of a country. The industrial development of countries like Germany, the U. S. A. and Japan has been brought about by these institutions.

AGRICULTURAL BANKS

Agriculture has its own problems and hence there are separate banks to finance it. They may be divided into two sections: one for meeting the long-term needs and the other for meeting the short-term needs. Long-term credit is needed for making permanent improvements in land, buying more land and introducing better methods and costlier implements. Short-term credit is meant to supply funds for day to day operations of the agriculturists. These include buying of seeds and manure, personal and labour expenses and payment of water rates and taxes, etc. The nature of the securities offered by the agriculturists and the length of time for which capital is required make it impossible for commercial banks, exchange banks and industrial banks to take up this finance. Hence, we have got land mortgage banks and co-operative banks which render this service to the community, the former by catering for long-term needs, and the latter by catering for short-term needs.

Land Mortgage Banks create negotiable bonds out of real estates. They may be urban or rural. Urban land mortgage banks finance house schemes and do not fall under the sphere of our study at this stage. Rural land mortgage banks have a large capital of their own. This may be raised by issuing shares or debentures. As it employs its capital in taking up mortgages, it issues bonds to the public on their security. The money raised by one set of bonds is used for taking up other mortgages and one mortgage affords security for other bonds and so on. Loans are advanced by these banks only for productive purposes. The property is valued and sufficient margin is kept before making up the advances. Repayment is made by fixed annual instalments spread over the period of the loan, and a reasonable rate of interest is charged. Debenture bonds issued by these banks being safe and stable, there is always a great demand for them. Trust funds and insurance funds are allowed to be invested

in them. Real estates, such as houses and land are not easily transferable and many formalities imposed by civil legislation have to be complied with before they can be transferred. The securities created out of them by land mortgage banks being easily marketable, the difficulty is removed. The Credit Foncier of France, which was founded in 1852 and is said to be "the mother of all mortgage banks," along with many such institutions in Germany, Spain, Austria, Hungary and Japan is a thriving institution. The Agricultural Mortgage Corporation started recently has been doing well in England. In our own country, the number of such banks has been going up but the speed has not been considerable. In a country which is predominantly agricultural and the agriculture of which is the most backward, the need for such institutions is very pressing.

Co-operative Banks are the concerns of the agriculturists themselves. The task of supplying short-term credit to the scattered farmers in small amounts is so risky that no modern bank can undertake it. No doubt, there is the money-lender who, because of his local influence and close contact with them, is best-fitted for performing this job but his terms are so usurious that he has been regarded more of a 'loan shark' than of a helping hand. In fact, this is bound to be so because of the risk attendant to a business which is unsecured *in toto*. For long-term credit, the peasants have the security of land to offer but for short-term, there is nothing left with them except the plough, oxen and hut. Under the circumstances they have to depend upon their own selves and take refuge in co-operation, the idea of which is said to have originated in modern times in Germany during last century. The pitiable condition of the agriculturists of that country made a deep impression upon Raiffesin who tried to improve the matters by starting co-operative societies which are the associations of the borrowers themselves formed voluntarily with the purposes of raising funds for meeting their short-term requirements. "Pooling their joint resources and on the strength of unlimited personal liability, they borrow loans in the money-market which they distribute to the members for productive purposes at a low rate of interest. Loans are usually repaid by monthly instalments and are secured by promissory notes of members which with

two or more endorsements of co-members form the basis of their loans. The system has been rightly termed the 'Capitalisation of honesty.' Personal security is converted into marketable collateral for loans on a great scale." Besides meeting the need for short-term agricultural finance they have also proved to be useful in various other ways. They develop among the members the idea of self help, promote thrift, and train them in the art of self-government.

SAVINGS BANKS

Savings banks are not banks in the real sense of the word. They are only thrift promoting concerns with an object to collect and keep in safety the small savings of the poor and middle-class people. The deposits flowing from their customers exceed in normal times possible withdrawals, and this fact does not require their assets to be kept in liquid form. Nor is there any necessity of making only short-term loans by them like the commercial banks. Their choice in making these is, however, limited and, in certain cases by law, to the best and safest securities. Rules governing operations differ in different countries, but usually everybody is allowed to deposit his money and given a pass-book in which there is a copy of the customer's account in the banker's ledger. Withdrawals may be made generally once a week and notice is sometimes needed for withdrawing money beyond a certain amount. Overdraft can never be granted and there must remain always a credit balance in the account. There are different kinds of savings banks in the United States of America. In England, post office does this work. In our own country also, this is the case, though over and above it our commercial banks too have a savings bank branch attached to them.

PRIVATE BANKS

While different kinds of banks described above are banks run on modern lines, there are some private bankers who combine trading and banking and carry on their business in the most antiquated form. We have already studied of such bankers in the past in England. Their number even now is sufficiently large in this country and there is hardly a place here where one or more of these

is not present. Almost the whole of the agricultural industry and a considerable portion of the internal trade is financed by them. They require to be reformed, but as has been aptly remarked by one of the writers on this subject 'they constitute an indispensable element in the country's financial system, and not only India but the world would be poorer by their extinction.' In fact, there are some such bankers in every country in the modern days also.

MISCELLANEOUS BANKS

There are certain other kinds of banks which have arisen in due course to meet the specialised needs of the people. In England and America, we have got *investment banks* whose object is to control the distribution of capital into several uses. American Trade Unions have also got *labour banks* where the savings of the labourers are pooled together. Some of the colleges in this country have started *student banks* to receive the deposit of the specialised student community. *The merchant bankers or Accepting Houses of London* perhaps represent another highly specialised development of the financial structure. In modern times trade depends on credit. But when a merchant sells goods on credit to foreign merchants, he incurs immense risks and must, therefore, set up a machinery for watching them in every country to which he sells. These merchant bankers have taken up this job and in view of their close relations with the important importing agencies all over the world undertake to accept the exporters' bills on their behalf. Sometimes this is done on the recommendation of an exchange bank. Besides, there are the *London Discount Houses* whose business is 'to go about the city seeking for bills to discount.' Their resources consist of their own capital, deposits received from the public on the same lines as by the banks but at a slightly higher rate of interest, and the borrowing from the commercial banks in the form of weekly loans or sometimes even what is known as 'Night money'. They also act as bill-brokers between bill-holders and commercial banks. These are, however, a few instances. We have got all over the world numerous agencies carrying on one or the other

banking business.

TEST QUESTIONS

1. Show that specialisation has been carried on in banking also but not to the fullest extent.
2. What are the different classes of banks we generally come across ? Give a short description of some of them.

CHAPTER IV

FUNCTIONS AND SERVICES OF A COMMERCIAL BANK

Commercial banking, as we have seen, grew out of the need for a safe place of deposit when the people of London entrusted their savings to the goldsmiths. It did not take much time for them to realise that the business could be made profitable by re-lending what was received, provided it could be returned before it was required. Gradually, they learnt that the daily payments were more than counter-balanced by the daily receipts, and hence there was no necessity of this stipulation. Of course, they had to depend on their own judgment in granting credit, and took proper security for such loans, but sometimes they had to come to grief; and the repudiation of his obligation by King Charles II, whom they had made large advances is one of the earliest instances of this. From the above, it is obvious that borrowing and lending constitutes banking business and these are the two functions of the type of bank we propose to take into consideration. There are a few other miscellaneous services as well which are now rendered by these banks.

All these functions and services can be grouped under the following heads:—

- (1) Receiving of deposits.
- (2) Lending of money.
- (3) Agency services.
- (4) Miscellaneous services.

The first two are sometimes known as primary functions, the third secondary and the fourth, contingent.

RECEIVING OF DEPOSITS

Deposits are received under different heads of accounts, the most important of which is the current account, others being the fixed deposit account, the savings bank account, the home safe account, etc. The first deposits received

form a considerably larger fraction of total deposits these days as compared to that before the Great European War of 1914—18. Their sole aim is to promote thrift among the lower-income class people. This is also not a business suitable to commercial banks, but they have been doing it, and its importance has increased so much that we cannot ignore its study though we may not go in much details. The balance of a savings bank account is not allowed to go beyond a certain maximum. The account can be opened by anybody on his own behalf, on behalf of any minor relative or on behalf of any minor of whom he is the guardian, etc. Though money can be deposited in this account as often as the depositor wishes, it cannot be withdrawn more than once or twice a week. Some banks have begun to allow the use of cheques to their savings bank depositors. In certain cases, they also require a balance to be maintained in exchange for taking advantage of this facility. Interest is allowed on the minimum balance between the close of the 5th day and the end of a month. Sometimes notice is needed when sums over a fixed amount are required to be withdrawn.

Home safe account is akin to savings bank account. It was introduced by the authorities of the Central Bank of India for the purpose of promoting thrift amongst children. When this account is opened, the customer is supplied with a safe by the bank which he takes to his home and in which he places money from time to time. The safe is periodically taken to the bank to be opened, and the contents are then credited to the customer's account. Interest is allowed on the minimum balance of this account also as in the case of a savings bank account.

Deposits are received in various other accounts as well. Private accounts are meant to defray expenses of purely personal or private character. Special accounts for special purpose named thereafter can also be opened with banks. A recent example of such an account is marriage account meant to deposit money for performing marriage ceremony.

NATURE OF DEPOSITS

There are various ways in which bank deposits arise.

Customers may deposit actual cash or they may deposit rights to receive cash. These may be in the form of cheques, bills, promissory notes owing to them, etc. What the banker does in these cases is that he collects them and credits the customer's account with the proceeds. Deposits may also arise out of loans granted by the bank or through the process of discounting customers' bills. In this case, they are known as 'created deposits' and in actual practice the amount of such deposits is much greater than that of the deposits received in hard cash or in the form of rights to receive cash. It is wrong, therefore, to think that the amount of deposits which appears in the bank balance sheet is so much amount of cash. Macleod observes in this connection: "These figures do not show the quantity of cash at the command of the banks to trade with: but they show the quantity of business they have done and liabilities they have created. These apparent deposits, then, which so many writers think are cash, are nothing but the credit the banks have created in exchange for the cash and bills which figure on the other side of the balance sheet as assets." What actually happens when a customer is temporarily short of funds that he approaches the banker for a loan, overdraft, cash credit or discounting of bills. In all these cases, the latter, however, knows that the money is not required for hoarding; it is desired for making payments. He, therefore, grants accommodation usually on the understanding that actual cash will not be immediately withdrawn, but the borrower shall draw cheques upon him whenever he wants to make the payment. This right to draw cheques is also common to cash deposits. Hence, we may say that it may be created either by the customer or the banker. It is created by the customer when he deposits actual cash, and it is created by the banker when he grants loans. But the banker's power to create deposits is limited by the cash reserve that he holds. We may, therefore, repeat what J. M. Keynes said that loans are the children of deposits and deposits are the children of loans. But this is not thoroughly understood by many, and hence the belief that "credit is the mere creation of the bank clerk's pen, and that but for the malevolence of the wicked banker enough of it could be

have raised many a penniless struggler to a position of competence, nay, of absolute eminence, by their system of granting cash credits to any individual able to offer a satisfactory security, even if it be no more than the guarantee of two respectable house-holders." In our own country the most common and popular method of making advances by the commercial banks is that of granting cash credits. But they are never based on personal security. Cash credits, here, are based on the promissory note of the borrower backed by collaterals like shares, stocks, bonds or goods like cotton, jute, rice, etc. If the goods are left in the possession of the bank in its godowns, advances are made on their deliveries and *vice versa*. A fair margin is kept. The borrower is required to pay interest only on the amount of credit availed by him in the case of an overdraft. The only difference between the two is that while in the former case a new account which may be called an inverse current account is opened in the name of the customer, in the latter case, his current account is allowed to be overdrawn temporarily.

Money can also be borrowed by discounting bills of exchange. Presentday commerce is built upon credit. Cash transactions are only confined to the retail type of business. A great number of transactions belonging to the circle of industries is done on the basis of credit. The producer sells raw material to the manufacturer, the manufacturer finished goods to the wholesaler, the wholesaler to the retailer, and the retailer to the consumer on credit basis. It thus extends from one to another and we may say without any fear of contradiction that the entire industrial world of today is knitted up with a chain made up of credit. Without its existence in its most elaborate form, the modern large-scale production would have never been possible. Credit has accelerated the speed of the machinery of commerce. What actually is done when a credit transaction takes place is that the seller draws a bill of exchange upon the purchaser, requiring him to pay the amount mentioned therein, after the lapse of the period of credit allowed. This method of payment is very convenient. First of all, the use of a bill of exchange does away with the necessity of the use of coins or notes, it being generally

discharged through a bank. Secondly, a bill of exchange fixes the date of payment and is a legal evidence of a debt which can be realised through a court of law. If at the time of its maturity, the drawee fails to honour it, he cannot deny the debt ; the transaction which gave rise to the bill is not considered but the bill itself is regarded to be a *prima facie* evidence of the debt. Thirdly, it can be transferred by the holder in settlement of his own debt. Finally, it enables the holder to obtain the cash before maturity by being discounted at a bank at any time after an issue ; and this is a very important advantage which a bill provides to businessman who carry on their business on credit but need ready money from time to time.

Discounting bills is the most important form in which a bank lends without any collateral security. The personal security of the acceptor and the drawer is the only security which the bank has in this case. Sometimes, bills are first of all discounted with a discounting house or bill broker who in his turn discounts them with a bank. In such a case, there is an additional security. There are special firms and persons doing this business in London. In India also, many bills are discounted through *shroffs* or indigenous bankers. The discounting bank deducts a certain rate of interest from the face value of the bill and credits the amount to the holder who may draw cheques to that extent. It, then, keeps the same till maturity and collects it from drawee's bank. Every acceptor, as a rule, has to instruct his bank where the acceptance is generally made payable, to honour it and debit him with the amount.

Bill discounting provides a banker with an ideal form of investment for the following reasons :—

(1) The amount payable by the acceptor is fixed, and is not subject to any alteration ; while in the case of other forms of investments, the value of the security concerned may change and very often fall resulting in a loss to the bank.

(2) The payment of a bill on due date is regarded as a matter of honour, and hence there is a certainty of it.

(3) A bank manager can so arrange his bill portfolio as to ensure a continuous supply of money by discounting

bills maturing successively. This is possible only because the employment of funds in it is for a definite period

(4) A central bank is always prepared to rediscount the bills of the commercial banks provided they conform to the standard laid down by it at what is known as the *Bank Rate*.

(5) The discount being deducted in advance and on the face amount of the bill and not on the amount advanced, if the rates of discount and interest chargeable are the same, the yield provided is higher in this case, and the banker can make an earlier use of the charge or charges, than in the case of other forms of lending or interest charge or charges on them.

But this business, if carelessly handled, is also fraught with dangers specially because there are many classes of bills—genuine and non-genuine. And it is next to impossible to distinguish the one from the other. A genuine bill of exchange arises out of a trade transaction, and can, therefore, be cashed on maturity by the sale of goods on which it is based. But a non-genuine bill of exchange being based only on the credit of the parties, its encashment on maturity is doubtful. Sometimes, a bill of exchange is accepted merely for the purpose of obliging a business friend who gets it discounted with a bank and thus obtains funds for the time being. The drawer undertakes to remit the face-value of the bill to the acceptor before maturity, and in case there is a default it is possible that it may not be honoured on presentment. As Rau observes, "If too many kite bills or finance bills are created and discounted there is the possibility that the expectations of the drawers and drawers might not be realised in which case they might be unable to pay back the sum and the banker would be a loser. These bills are based on credit and an improper use of credit is at any time possible." Accommodation bills are also known as kite bills. The term finance bills, on the other hand, is used for anticipatory bills. These are drawn not on the basis of real produce in existence, but in anticipation of that produce. They are very common in America, and are meant to finance the agriculturist to enable him to meet his current outlay.

They, too, are not safe for a banker to accept because the property of a crop is of a doubtful nature after all.

AGENCY SERVICES

Bankers also act as agents of their customers in various ways. They collect and pay their cheques, bills, promissory notes, coupons, dividend warrants, subscriptions, rents, income-tax, insurance premia and other periodical receipts and payments. They purchase and sell on their behalf shares, stocks, debentures and bonds, etc., on the stock exchanges, and other valuables in other markets. They also act as administrators, trustees, executors and attorneys, etc. In short, they can be made to do anything on behalf of their customers provided they are paid for their services. In some cases, even this payment is not necessary. The services mentioned above are more than often performed gratis with a view to attract deposits from the public. There are, however, certain important responsibilities placed on them when they act in this capacity.

MISCELLANEOUS SERVICES

Under miscellaneous services may be included a number of functions performed by the bankers. They receive their customers' valuables, ornaments and jewels, documents and deeds, etc., for safe custody. They also act as their referee. Whenever anybody wants to know about the financial position of a business concern, he is referred to its banker, who supplies him with detailed informations. They also make confidential enquiries about the credit of a prospective buyer so as to enable their customers to enter into important business dealings with him. They issue letters of credit of various kinds and bank drafts to their customers, thus making money available to them in the places it is required; and bring about its transference between different towns and countries. The more important function of a banker, however, consists in his coming of moral virtues. "An efficient banking system, on the other hand, improves the tone of credit and the business morality of society to such an extent that banks are termed the coiners of probity, reliability, honesty, integrity and ability. Such virtues as honesty, good faith, the encouragement of sound

principles and practice that engrain into the character of a nation and the sanctity of implied contracts are better impressed under a highly complex credit system than in the simple monetary system"⁷✓

TEST QUESTIONS

1. Give a brief description of the functions of a commercial bank.

2. What are the different classes of accounts in which deposits are received by a bank? Give important characteristics of each.

3. What are the different ways in which bank deposits arise? State how far they provide a source of strength to a banker.

4. Comment on the statement · "Credit is the mere creation of the bank clerk's pen"

5. Keynes says, "Loans are the children of deposits and deposits are the children of loans." How far do you agree with him?

6. What do you say of Lord Overstone's statement regarding a bank's lending operations, viz., "It is my own brain and other people's money".

7. Give a short description of the various forms which a bank loan may take. Why is it that discounting business is so popular with bankers?

⁷*Elementary Banking* by Rau, p. 29.

CHAPTER V

BANKING OPERATIONS OF A COMMERCIAL BANK

Banking operations of a commercial bank may be studied under four heads, viz.,

- (1) How a bank gets its working capital.
- (2) How it employs its working capital.
- (3) How it earns profits ; and
- (4) How it distributes profits.

HOW A BANK GETS ITS WORKING CAPITAL

There are various ways in which a bank gets its working capital. First of all, like other institutions, it issues shares. The promoters of a bank decide the amount of capital with which it is to be registered. The aggregate capital is split up into a number of equal units of round sums, each being called a share. These are, then, offered to the public for subscription. Sometimes all the shares are not issued at the commencement, quite a large number of them being retained for a future issue. All the shares issued may also not be subscribed to by the public. In case the minimum number as laid down in the prospectus is not applied for within a given time, no allotment can be made, and the bank does not come into existence. The whole money due on each share may also not be called up, a portion may be left to be called up later on if need be. All the shareholders may also not be able to pay up all the calls. Thus, there are various forms of capital and so there are different names for each. The capital with which a bank is registered is known as its *registered, authorised or nominal capital* ; the capital issued as *issued capital*, the capital subscribed as *subscribed capital*, the capital called up as *called up capital*, and the capital paid up as *paid up capital*. The difference between paid up capital and called up capital is known as *calls in arrears*. They may not be carried forward from year to year. After the lapse of a reasonable time, the shares of those persons who do not pay up all the calls in full are forfeited and

re-issued to others. The difference between called up capital and subscribed capital is known as the *reserved liability of the shareholders*. In the case of an individual banker, or a partnership, the individual concerned or the partners are all personally and individually liable for the debts of the business. This means, if after taking the whole property of the business its debts remain unsettled, the private property of the individual or of partners is taken. "This is equitable enough in the case of a single man's enterprise or in a partnership enterprise where the individual owner or each of the partners take a personal share in the conduct of the business, but when joint stock companies came into prominence, the doctrine of unlimited liability pressed rather hard on shareholders who had practically no control over the business policy of the company. In 1855, therefore, an Act was first passed in England allowing trading companies under certain conditions to get themselves registered under limited liability principle, the shareholders being liable to the extent of their nominal holdings of shares only. Banks were excluded from this privilege, it was thought, that bankers were in such a responsible position and were debtors to the public in such large amounts, that it was unwise to afford them any protection in this respect. Two years later, in 1857, a severe monetary crisis resulted in the failure of several banks, notably the Western Bank of Scotland. It was found that the wealthier classes declined to incur the risk of holding bank shares and a large proportion of the shareholders of defaulting banks were not possessed of sufficient means to contribute towards the debt of the company. In order, therefore, to attract a more substantial class of shareholders it was found desirable in 1858 to extend the privilege of limited liability to such banks as cared to register under the Act. Most of the large joint stock banks, however, kept aloof, fearing that the limitation of the shareholders' liabilities would alarm the depositors and result in a loss of business. But the collapse of the City of Glasgow Bank in 1878, and the complete ruin of most of its shareholders caused such a panic among those who held shares in joint stock banks, that most of the banks were induced to register themselves as *limited*. A new Act was passed

in 1879 which created what was called *reserved liability*. Under the terms of this Act, limited companies could increase the nominal amount of their shares with a condition that a certain proportion of such nominal increase should not be called up except in the event of the liquidation of the company, this uncalled proportion of the share capital being termed *reserved liability*. The effect of this provision was that while the shareholders of the companies were partly protected, in that the amount they could be called upon to pay in the event of liquidation was a definite ascertained sum, yet the depositors and the other creditors of the bank felt that they had a reasonable security for the payment of debts due to them."¹ Since then the practice continues, and banks having reserved liability are, other things being equal, given preference over the banks having no reserved liability by the depositors. It may also be mentioned here that the principle of limited liability was introduced in this country in 1860, and as a result a number of banks were established in important towns during the period that followed. The difference between subscribed capital and issued capital is not found in the case of the first class concerns as their shares are all taken up by the public as soon as they are issued. The difference between issued capital and registered capital shows the amount which can be raised by issuing shares in case the expansion of business necessitates it. From all this it is obvious that it is the paid-up capital which is important from the working point of view and forms a portion of the working capital of a bank. But this is, as we shall see presently, a very small part of the whole. Before taking up other sources we may add that the shareholders who provide this money expect an annual return in the form of dividends. The banks earn profits and use a portion of it for this purpose, but there is generally something saved for building up what is known as a reserve fund. As this is the money which would have ordinarily gone to the shareholders, it may also be regarded as a part of the capital and included in the amount available for carrying on with the business.

¹*Banking by Sykes*, pp. 93—95.

Second and invariably the main source of raising capital these days is that of deposits. As has already been seen they are received in different forms and accounts. Only those deposits which are received in the form of cash or in that of the rights to receive cash add to the working capital of a bank. Deposits arising out of the discounting of bills or of the granting of loans in other forms do not in any way add to it. The former are known as direct deposits and the latter as indirect deposits. Bankers can also make use of their customers' money falling in their hands in connection with what is known as agency services so long as they are not used up for the purposes directed, e.g., in case they receive money for remittance, so long as it is not paid out to the payee it can be used by them.

But the whole deposit business of a bank consists in the exchange of rights against rights or of rights against money.² When a banker receives cash, he grants a right to the depositor to withdraw it whenever he likes. When he receives bills of exchange, cheques, promissory notes, dividend warrants and coupons for collection, he receives rights to obtain money and grants in its stead rights to draw it. When he receives subscriptions, rents, income-tax, insurance premia and other periodical payments, he receives money and gives the right of its withdrawal to those on whose behalf he receives it. In remittance business too, he receives money in exchange for the rights to withdraw it, and in the case of what are known as indirect deposits or created deposits, it is nothing except the exchange of rights against rights. In other words, it may be said that all this business consists of dealing in credits as there is always an element of confidence in every transaction that takes place between a banker and his customer; without it nobody would entrust the other with money or rights to receive money.

As is observed by Rau "the deposit function of the banker is important because it has to aggregate small sums of money lying scattered here and there in twenties, fifties and hundreds. Singly these sums have no economic effi-

² *The Theory and Practice of Banking* by Dunbar, page 16.

ciency whatsoever. But they can accomplish Herculean tasks when they are aggregated and employed by the banker.} According to Bagehot 'The concentration of money in banks though not the sole cause is the principal cause which has made the money market of England so rich and so much beyond that of other countries'. This pooling operation of the banks and releasing the capital presumably to those who employ it in the most profitable way in the trade and industry is the first economic service that banks render to society and their efficiency depends on the total wealth of the people they have amassed in their hands and the total demands of industry and trade on the other side would settle the loans that the banks can make".³ But banks in India cannot be regarded as sufficiently efficient because the total wealth of the people they have amassed in their hands and the total demand of industry and trade they generally meet is not considerable.

Banks by allowing their customers to draw cheques against their deposits also 'create additional purchasing power. This may be regarded as the second important service which they render to society. To quote Rau again, "deposit currency or cheque currency or bankers' money as it is properly styled is eminently elastic as these cheques can be multiplied by the banks to any amount within the limits of comparative safety and considerations of social interest as there are no legal regulations binding this side of banking business." ⁴ On what the limits of comparative safety depend and what these considerations of social interest are have already been dealt with elsewhere in this book ⁵ A violation of this may result in the turning up of this service into dis-service. Crossing the limit of safety may bring about a failure of the banks and avoidance of the considerations of social interest may raise the price level to an extent which may be detrimental to the society. It is easy to expand credit but difficult to raise production in exactly the same proportion.

³ *Elementary Banking*, pp. 56-60.

⁴ *Op. Cit.*, page 60.

⁵ See Chapter III, page 18.

As a third source of raising capital may be mentioned that of the note-issue, though it has now receded to the background. "The issue of notes, as of other currency, was always claimed to be a prerogative of the state, but whereas in the case of metallic currency, the state retained its prerogative, it decided with few exceptions to hand the issue of notes over to banks when these, like note currency itself, were brought into being as a result of the need for means of facilitating the exchange of goods. Banks were given the right to issue notes or where banks had already put into circulation notes of their own in one form or another, they were legally authorised to continue issuing notes, subject to certain safeguards imposed by law."⁶ But it was soon found necessary in order to bring about uniformity in this business and supervise it better and share in the profits arising out of it by the state to grant one bank either a complete monopoly or a residuary monopoly which according to Vera Smith denotes a case where there are a number of note issuers, but all of these except one work under narrow limitations, and this one authority is responsible for the bulk of circulation. We have already seen that this took place in England in 1844. The same had already taken place in Holland in 1814. In France it took place in 1818, in Germany in 1875, in Sweden in 1897, in United States in 1914, in Union of South Africa in 1921, in Colombia in 1923, in Australia in 1924, in Chile in 1925, in Italy in 1926, in New Zealand in 1934, and in Canada in 1935.⁷ In India, the banks had the power of note-issue till 1861, when it was annexed by the Government of India and in 1935, it was transferred to the central bank of the country, *viz.*, the Reserve Bank of India.

When a bank issues notes, it creates working capital for itself. The first notes issued were in exchange of the receipts of actual cash, and as in the case of the deposit receipts, it was soon discovered that the bank was not required to pay up all the notes at one time, and that it could use a considerable portion of the actual cash in

⁶Central Banking by M. H. De Kock.

⁷Central Banking by M. H. De Kock, page 21.

whatever way it liked without even in the least impairing their convertibility. So long as the credit and business reputation of the bank was unimpeachable the notes were considered as good as cash and circulated like legal tender money. Gradually they began the issuing of notes at the time of discounting bills and granting loans in other forms, and the people accepted them without any objection. Thus there was no difference for the bank if its credit creation took the shape of a bank note or deposit. If at all there was any difference it was one of form. But the bank deposit being more useful to businessmen than the bank note, and restrictions having been placed on the issue of the latter, as has already been pointed out, the former came into greater prominence and now forms a much more important part of the circulating media of the advanced countries of the world. It will not be out of place to mention here what Rau says about the identity between the two. "Both of them can be used for the purpose of making advances to customers or in exchange of promissory notes or bills of exchange of customers. Both of them serve as promissory notes or bills of exchange of customers. Both of them serve as means of payment. Both of them represent the right to demand legal tender money from the bank. Both are sources of income to the bank. Both are demand liabilities from the viewpoint of the banker⁸ But proceeding further, he also points out the difference between them. "Bank note is a safer liability than the deposit and the bank considers it advisable to issue credit in the shape of notes in preference to deposits. So long as there exists confidence in the issuing bank no depression of industries destroys the use of the bank note. A deposit may be utilised at any time by the customer to meet his own obligation. The smaller bank notes remain out in circulation for a long time and very often return as deposits. The bank note has a greater circulation power than the cheque. If the moon is the poor man's lantern the bank note represents the poor man's banking account. So there is not much trouble in the issuing of notes in response to the legitimate demand

⁸ *Elementary Banking*, Page 78.

on the part of the people." But all this is theoretical, as the power of the bank to issue notes has in practice been taken away from them.

HOW IT EMPLOYS ITS WORKING CAPITAL

From the above discussion, it appears to be quite obvious that almost whole of a bank's working capital except that received from its shareholders or withheld out of profits from distribution by way of dividend and accumulated in the form of reserve fund, constitutes its demand liability and must be made available at all times. But as has been remarked elsewhere, banking business consists in circulating capital and not locking it up. It is in this circulation that a bank manager has to use his brain. He must allocate his funds over different investments besides maintaining a reserve in such a way as to be able to replete his funds whenever need be. There are sure to be many occasions after short intervals when funds may be withdrawn in huge amounts. In many cases, such periods coincide with demands for additional loans from regular customers, and they must also be satisfied. We will, therefore, attempt in the following pages to look to the way in which a banker selects his assets and varies them and considerations which guide his intelligent judgment and choice. -

A prudent banker always chooses such interest-yielding investments as may be readily realised and fall due in a steady succession. He measures economic forces constantly and takes a particular line of action in changing the form of his assets only after their due considerations. Broadly speaking, we may divide them into two classes: (1) those which are put to non-profitable uses and (2) those which are put to profitable uses. In the former are included his cash reserves and acquisition of what is known as *dead stock* and in the latter are included call money, discounts, advances, investments and acceptances, etc.

First of all, let us take up cash reserves. They consist of *till money*—money kept in a banker's vaults—and money kept at the central bank. These together form

his first line of defence and are primarily intended to ward off bankruptcy. In short, it is a precautionary measure and it should always be the endeavour of a banker to build up adequate cash reserve and to strengthen it when necessary by all possible means. The usual method adopted for this purpose is to convert the ultimate availability into immediate availability. As to the percentage of cash reserve to demand liabilities, as has been pointed out, it will depend upon various factors and be always varying. These may be enumerated below :—

(1) In some countries, the legislators have fixed certain proportions to be observed by the banks. They certainly help amateurs and keep under restraint adventurous banks. But beyond this, they do not go. More reliance must be placed on the integrity, wisdom and judgment of bankers themselves than on banking laws to regulate them. A legal limit tends to give a sense of false security, and the banker may think that he has done everything he has to do by keeping the prescribed legal limit of cash reserve. It is also difficult to say as to what this legal limit should be, as is evident from the difference in the limits prescribed by different legislators. For example, in Denmark it is 10% of demand deposits only, in U. S. A. it is different with banks in different localities, in Argentina, it is 8% of time deposits and 10% of demand deposits, in Chile it is 8% and 20% respectively, in Ecuador it is 10% and 25% respectively and in Bolivia it is 10% and 2% respectively. In some countries, the minimum cash reserve percentage includes both the reserves in the central bank and in the banks' own vaults, and in others it includes only one. In India, scheduled banks are required to keep a cash reserve of at least 5% of their demand and 2% of their time deposits each with the Reserve Bank of India; but as far as the cash reserve in their own vaults are concerned there is no legal requirement to be fulfilled. Non-scheduled banks are, on the other hand, required to keep only 1½% of their time and 5% of their demand deposits each in their vaults.

(2) It also depends upon the percentage kept generally. If one bank in a locality keeps a higher percentage, other

banks in that locality must also keep the same to win confidence of the people. English banks keep a much lower percentage of cash reserves than the banks of other places.

(3) The size of the cash reserve of a particular bank will also depend upon the average size of the deposits of each customer. It shall have to be such as to be able to meet heavy withdrawals of the depositors having maximum amount of deposits.

(4) If cheque habit is sufficiently developed and payments are not generally made in cash, the amount in reserve may be smaller than if otherwise is the case.

(5) If clearing system is well developed, most of the cheques drawn on a bank are counter-balanced by those received by it but drawn on other banks, and hence there is very often not the need felt for finding out actual cash for their payment. It may, therefore, be said that in a country where this system has reached the point of highest efficiency, a percentage of less cash reserves would do.

(6) In case banking habit of the people of a place is sufficiently developed and they are not used to hoarding, there is a constant in-flow and out-flow of funds into, and from, the banks which means that they can carry on with smaller cash reserves than is possible *if otherwise is the case*.

(7) If the customers of a bank belong to such classes as bill brokers or discounting firms whose accounts are of a fluctuating nature, a larger cash reserve would be required to meet the heavy withdrawals at times when there is a greater need of money to them due to increase in business.

(8) If the investments of a bank are such as can be easily liquidated, a smaller cash reserve would be necessary, as they would be realised whenever required. In countries where there are highly developed money markets and bill markets, money is invested in them and can be called up or realised at any moment. In England, a considerable sum is lent to bill brokers and stock exchange brokers who pledge sufficiently high class bearer securities to cover the loans and promise to return them within a period of three to ten.

days or in some cases the next day. Practically, though these loans expire within a short period or each day, they are to a large extent continuous. They go by the name of '*money at call and short notice*,' though they are usually denoted by the term '*call money*,' and in case of the loans payable next day, by the term '*overnight money*' also. Then, there is bill discounting business. Bills, as has already been observed, provide an ideal form of investment. In case, there is a central bank, and we find on these days in almost every country of importance, the bills are rediscounted with it, if there is a pressing need to meet unprecedented demands.

(9) Finally, if banks are situated in a commercial area, they are required to keep a much larger cash reserve than if they are situated in an agricultural area, for the payments in the former are much heavier in proportion to the average balance than in the latter.

Coming to the acquisition of dead stock, it consists of buildings, fittings, fixtures and furniture, etc., etc. These are very necessary for carrying on the business of a bank. "The bank building must be adequate in size and imposing in appearance." In fact, it serves as a means of advertisement—'good premises attract good customers'. It should be 'burglar and fire proof'. There should also be special rooms for storage of old and current records, etc. But in spite of all this any 'undue extravagance' in it is not desirable. In the words of Rau, "It is always preferable for a bank to have solid cash in its hands rather than invest it in brick and mortar." Dead stock cannot be disposed of whenever desired firstly because it is not easily marketable, and secondly because its sale brings the bank into disrepute. It is realised only after liquidation of the bank and not before.

We will now take up the profitable use of the working capital. Having sterilized a portion in dead stock and cash reserves, a banker considers how he is to employ the rest; by lending out for shorter or longer periods. Obviously, as far as possible he will like to lend a consider-

⁹ *Elementary Banking*, part 172.

able sum only for short periods. But before proceeding to do this, he also tries to have some such money as may yield a small income to him and at the same time be available at any moment. This is, fortunately enough, made possible in some countries due to the demands arising from the bill brokers and stock exchange brokers. The former seek accommodation for employment of money in the purchase of bills and the latter to take up stocks in the intervals between the fortnightly settlements. They offer such securities—consols, exchequer bonds, the debentures of Indian Railways and the bonds of the Corporation of London and the London City Council—as enable the banker to ‘go to sleep with an easy conscience’. The name given to this investment is *loans at call and short notice*. Professor Taussig says, ‘from the point of view of the bank, they are a highly convenient part of its business. A profit is certain, sometimes large, sometimes small, but always appreciable and yet the bank’s resources are not tied up and cash can be called back—at least by the individual bank, if there is a more profitable use for it elsewhere, or if there is a sign of danger. And from the point of view of the public advantage, there is also some gain. For sundry useful business transactions funds are wanted over short but certain periods and for them demand loans are adopted’. Rau says, “In the case of call money, the banker seems to accomplish the impossible feat of ‘having the cake and eating it too’.”¹⁰ But they are not free from evils altogether as “they encourage gambling speculation. Besides, they are very good assets in normal times, but in times of panic they are useless or become ‘frozen’. At such a time it is difficult to get payment of such loans, and the money so employed is locked up when it is needed most in a liquid form”. They are, therefore, not considered as good assets by many bankers. Lord Goschen has condemned them.¹¹ They are, however, very popular in London and New York. Coming to India, there were no

¹⁰ *Elementary Banking*, page 102.

¹¹ ‘It is not an asset which constitutes a reserve useful to the general interest of community at large.’

call loans lent to any great extent even in the Presidency towns (Bombay, Calcutta, Madras, Karachi) before the war. But after it they began to be lent freely. Call money is used here for dealings in the bullion markets and stock exchanges. It is, however, made available to first class parties only, though contrary to the English practice of asking for no security. The rate of interest on it varies according as the season is busy or slack. In the busy season, it is not available at any rate, while in the slack season, it is available at $\frac{1}{4}$ per cent. Of late, this money is being invested in Government of India Treasury Bills. It also figures prominently in inter-bank loans. One thing more may be mentioned in this connection, *viz*, that while on the security of such loans, borrowers in London fall back on the Bank of England, they have no alternative in this country.

But call loans are suitable for the employment of only temporary surplus funds. A considerable amount of the working capital requires, in fact, to be invested elsewhere with a view to earn more decent income. The ideal form of investment from the banker's point of view is, as has already been observed in the last chapter, that of bill discounting. This is a loan to traders, as opposed to bill brokers and stock brokers, though sometimes the former also take advantage of it. We know that bills are also discounted with a discounting house or bill broker who in his turn discounts them with a banker. It is to this that we refer when we say that bill brokers also take sometimes advantage of the bank's bill discounting business. Ordinarily, a bill broker discounts bills out of his own resources, and out of the money he borrows from the banks in the shape of call money, but there are periods when he has to discount them with bank. Generally, call money is used for taking up fresh bills in the hope that there will be sufficient funds available for paying it to the banks on the maturity of already taken up bills within a few days. We have already taken, in connection with the bill discounting business of a bank, a notice of the difficult position in which a banker is placed in discriminating between genuine and non-genuine bills. But something can be done by him in this respect too by keeping his

eye upon the accounts of those customers whose bills he discounts. It may also be mentioned here that every bank maintains a list of its customers whose bills it is prepared to discount. Besides, there is always an amount noted down against each name denoting the extent to which it is thought proper to discount his bills, and in case this is strictly adhered to there is nothing to be afraid of. A banker must also satisfy himself of the completeness of a bill before discounting it. In other words, he must see that it has been drawn, accepted and endorsed in the regular manner. He must also scrutinize the business career of the drawer, the acceptor, and various other endorsers as it is with them that the redemption of a bill lies. Then, he must not discount bills arising out of transactions of only one class of commodities, as in the case of a depression in it there will be a danger of the whole money being locked up. Finally, he must distribute his funds allocated for this purpose over bills with successive maturities. This will enable him to meet the continuous demands of his customers.

This brings us to advances or what are better known by the terms loans and advances to the customers. In fact, "under this comprehensive heading anything that the banker does in the shape of lending his credit can be arranged. Even discounting leads ultimately to lending the banker's credit and the discount rate might be defined as a charge for the loan of capital. But for better understanding of the subject the various operations should be specially studied. Hence call money and discounting bills are generally studied apart from the loan operations."¹² We shall now deal with the banker's policy regarding overdrafts, cash credits, loans on promissory notes and collaterals, and personal loans. It is needless to say that his profits depend on their preponderance. But at the same time this is not consistent with safety. The risk arising from it may, however, be reduced by taking due precautions. Though some of them have already been discussed, yet they may be recapitulated here along with others.

¹²Rau's *Elementary Banking*, p. 124.

1. The banker should always be careful to see that his cash reserves do not stand very near the danger line. It is better to err on the safe side rather than on that which may be risky.

2. As the popular saying goes "he must not lay all the eggs in the same basket." This means he should not lend too large a portion of his loanable funds to any single borrower. It suggests that funds should be spread as far as possible over wider area. He must not concentrate over the financing of only one trade or on the security of only one kind. A violation of these principles has resulted in failures.

3. He has to judge aright the nature of the securities that can be accepted by him. What George Ray says in this connection has already been given in the last chapter. A close scrutiny must be made of the security offered from various points of view by a banker. But as will be clear from the examination of the nature of various securities in a subsequent chapter, none of them proves to be ideal. Mortgage of real estate is the worst security. It cannot be easily and quickly sold and is subject to much fluctuation in value.

4. He has to bear in mind that he has to finance only the current transactions of the community. He is not required 'to coin all kinds of unmarketable wealth into money.' Nor is it expected of him to coin credit for future needs.

5. He should be cautious in providing for a good margin in his favour. The greater the possibility of the fluctuation of the security the larger the margin required.

6. Commercial banks are meant to create only short-term credits and any diversion from what is their legitimate requirement is sure to result in a catastrophe. No doubt, European banks and specially German banks undertook financing for long terms, but the nature of their deposits too varied from that of the banks in England or India, and hence it could be tolerated. The first question put to a prospective borrower should be regarding the period for which a loan is required, and the first answer to it should

guide the banker in the determination for granting the loan as far as this is concerned. Sometimes, it has been observed that in case a loan for a long period has been refused, it is asked for a short period on a promise of repayment after making a permanent arrangement for it from somewhere else. But this is never done, Walter Leaf gives illustrations of two such instances ¹³—in the case of one the permanent loan was to be raised by securing mortgage with an insurance company and in the case of another it was to be raised by issuing new shares—but steps were never taken to fulfil the promise. Such loans drag on under various pretexts and become a part of the borrower's working capital.

7. Continued renewal of loans is also undesirable as they become very often bad and 'frozen'—incapable of being realised in case of an emergency. 'Nursing of accounts' as it is called is bad.

8. The object of the loan should also be enquired into. It has been suggested that creation of credit for consumption purposes should always be discouraged. But what is of more importance is not the purpose for which a loan is negotiated but the capacity and means to make the payment. They must be enquired into and taken consideration of. Sometimes, however, borrowers make impossible proposals, and these must be turned down by the bankers not only in their own interests but also in those of the borrowers themselves. They should satisfy them of their futility and thus save the people from ruining themselves.

9. He must also keep an eye on the price fluctuations of the securities lodged with him, and in case of the shrinkage of any one of them the particular borrower must be asked to furnish with collaterals.

10. Policy of cheap money is also not always good. It leads to huge borrowings but capital alone is not required for business prosperity and hence they may be put to waste and result in ultimate loss.

11. Finally, the character of the borrower should be the main consideration. In fact, a good character is an ideal

¹³*Banking*, pp. 166-7.

security. People seeking for bank credit must inspire confidence because it is a key-note to credit. But it comes from the cultivation of moral qualities, *vis*, honesty, sobriety, promptitude, uprightness and regularity.

As regards the forms these loans and advances can take, we have already gone through them. It has also been observed that they may be secure or unsecure. As regards the nature of the various securities offered, we shall look to them in a subsequent chapter. But sometimes loans are unsecure or else, they are granted on personal security. In this, borrower's character is more important than it is anywhere else. His total wealth and repaying capacity are also required to be considered. Every banker has certain customers who stand more or less in the nature of patrons to his business. He should not hesitate in giving them accommodation even if they do not offer any collateral. They demand loans only in an emergency, and in the interests of the banker their resentment and displeasure should in no case be incurred by a refusal. In fact, if such loans are granted after taking due consideration of the borrower, there is nothing to be afraid of, and experience goes to prove that such loans have not resulted in any loss in the majority of cases.

Banks also invest money in Government, semi-Government, railway, public utility service and industrial securities. Strictly speaking, this is not a banking business, it consists of the circulation and not of locking up of capital. They employ their funds in this business not because it is very productive but because it is capable of easy realisation in the event of any unforeseen and large demand. Annual yield from such funds is not at all alluring. It is less than that on discounting or loaning in many cases. No doubt, in the event of a possible rise in the value of the securities, there are chances of considerable profit, but that is speculation, and a bank should always avoid it. But they can be sold in the stock-exchange markets at any moment, and hence they provide an ideal form of investment, at least as far as their convertibility goes. Government securities which are known as gilt-edged securities are perhaps the best

from this point of view. They are also generally not subject to much depreciation. But it may be said that here also banks do not invest in only one kind of security, be it Government or any other. Their funds are distributed over several first class securities.

Yet another form of loaning operations of a bank consists in acceptance business. We have already seen before that a bill of exchange when drawn by a seller upon a buyer is required to be accepted by the latter. But it is possible that his credit may not be sufficiently known and even if the seller does not hesitate in accepting it, he might not be able to discount it. In such cases the bank comes forward and accepts the bill on behalf of the purchaser who is also his customer. What it does is only that it substitutes its own 'wider and well-established credit for the narrow and unknown credit of the trader'. For this useful service it is needless to say that it also charges a commission. The business was in fact started by the great merchant banking houses of the continent after they had established their offices in London on the fall of the supremacy of Amsterdam in international finance on account of the defeat of Holland by England during the Napoleonic war of the nineteenth century. They had, it seems, foreseen that the capital of the British Empire was 'destined to supplant' that of Holland as the pivot of international finance. Some of the important houses were also of American origin. Though they do not claim to be bankers as they do no proper banking business, *viz.*, that of receiving deposits withdrawable by cheques, they are fairly important just like banks. They have got their relations with the people in important countries of the world and keep informations regarding financial position of the importers in those places. This enables them to accept on their behalf the bills drawn by the exporters. Their standing is such that their undertaking to pay the bills enables the exporters to discount them with any bank. Generally they require an undertaking by the purchaser to place them in funds at least three days before the maturity of any bill. At present, bills are accepted by these houses on the recommendation of the exchange banks too. Since the war of 1914—18 the Americans have

also done something to make a *rival* centre in New York, and hence such houses have sprung up there too. The accepting business has also since then gone a good deal in the hands of the banks. When war broke out, London Acceptance Houses had to receive money from the people in most of the enemy countries on whose behalf they had accepted bills, but the State forbade the collection of debts from an enemy. But it was necessary to protect their credit also. and hence it was provided that the acceptances of these houses, as they became due, should be taken up by the Bank of England. Their business was, however, much hampered and gradually English joint stock banks had to take it up. The Federal Reserve system of the United States of America also recognises this business as a legitimate banking business. As far as India is concerned, it may be said that Indian joint stock banks are not in the habit of doing this business. There is, however, the Indian *shroff*, who, though does not actually accept bills on behalf of others, purchases them from traders about whose standing he has no doubt and thus puts his signatures on them. This becomes a sufficient guarantee of their payment and they are, therefore, discounted if necessary at the scheduled banks.

HOW IT EARNS PROFITS

Now, we come to the question as to how a commercial bank earns profits. We have already gone through the profitable uses to which a bank puts its working capital. In fact, they may be regarded as the main sources of its profits. We may again enumerate them here for the sake of clarity :—

- (1) Interest on Call Loans.
- (2) Discounting charges on bills
- (3) Interest on loans and advances.
- (4) Interest on investments.
- (5) Commission on acceptances.

To these may be added income from incidental charges, and commission on account of agency and miscellaneous services rendered by it to the business community in general. We know that banks collect and pay their customers' cheques, bills of exchange, promissory notes,

coupons, dividend warrants, subscriptions, rents, income-tax and insurance premia, etc. Most of this business is done gratis. But usually in case of collection from and payment to outstations, a charge is made. When they purchase and sell on behalf of others shares, stocks, debentures, and bonds, etc., on the stock exchanges, and other valuables in other markets, they also charge a commission over and above what they pay to the brokers. Besides, they get remuneration for acting as trustees, executors and administrators of family trusts, etc. When they receive valuables, ornaments and jewels, documents and deeds, etc. for safe custody, they often make a charge for it. The business is no doubt not free from danger but the risk has to be taken in most cases; and this form of service, even if it may not yield a substantial income is a very material addition to what a banker should do for his customers. It may also be said that in cases of the custody of credit instruments, banks are also liable to collect interest and payment when they fall due. Remittance and exchange business too is very lucrative. In India, most of the commercial banks earn a huge sum on account of the former. But exchange business is exclusively in the hands of foreign exchange banks.

HOW IT DISTRIBUTES PROFITS

The above are the sources of profits. But the whole amount thus earned is not available for distribution by way of dividend amongst shareholders. From it are required to be deducted certain expenses which must be incurred by a banker during the course of his business. These consist of :—

- (1) Interest on fixed deposits and other accounts ;
- (2) directors' and auditors' fees, staff salaries, and contributions to pension or provident fund ;
- (3) membership fees of the bankers' associations, and chambers of commerce, etc ;
- (4) office expenses, *e.g.*, printing, postage, advertising, stationery charges, rent and insurance premia ;
- 5) travelling charges and payment to agents and correspondents ;

- (6) provision for depreciation of investment, and dead stocks ;
- (7) bad debts and defalcations made by bank clerks ; and
- (8) income or other taxes.

The net profits of a bank depend on capable management. Deposits are sometimes attracted more by granting facilities to the customers and rendering useful services to them than by offering high rates of interest. It is no use keeping low paid staff. It cannot attain the required standard of efficiency. In India the practice of keeping managers on Rs. 40 or Rs. 50 per month initiated by some of the smaller joint stock banks has very often resulted in increasing defalcations. A high salaried staff is usually much cheaper in the long run. It proves capable of attracting a larger business and carrying it without any flaw or hitch. Bad debts are reduced to the minimum and defalcations do not occur at all. Out of the net profits a considerable amount is also set aside after distributing dividends at a steady rate for what is known as reserve fund. It is sometimes created with a view to balance dividends in lean years, but more often to increase the bank's capital so as to conform it to the requirements of increasing business.

TEST QUESTIONS

1. What are the different ways in which a bank raises up its working capital ? Give a short description of each.
2. What is the nature of the deposits of a banker ? Explain in this connection what you understand by the term 'created deposits'.
3. Give a short description of the different types of capital of a bank. What do you understand by the reserved liability of the shareholders ?
4. 'The whole of the deposit business of a bank consists in the exchange of rights against rights or of rights against money.' Comment.
5. What services are rendered by a banker by his deposit business ? Is there any possibility of his doing a dis-service to the society ?

6. "Both the deposit business and note issuing business of a bank are identical." Comment.

7. What are the different ways in which a bank employs its working capital? Explain in this connection the use of call loans

8. What precautions should a banker take while making loans and advances to his customer? Explain as clearly as possible.

9. What do you know of the acceptance business of the bankers? Give a short description of its beginning.

10. What are the different ways in which a banker earns his profits? Is the whole of it available for distribution amongst the shareholders?

CHAPTER VI

CENTRAL BANKING

Central banking as a specialised business has come into prominence only during the present century. Prior to it, banks had been established in 'almost every country in Europe, along with Japan and Java in the East, and Egypt and Algeria, in Africa' with powers to issue notes and act exclusively as Government bankers, but they had, as was pointed out in chapter III, no clear concept of all the central banking functions. A sort of gradual evolution had, however, been taking place regarding them. Starting with the Bank of England, they had in varying degrees begun performing such functions as 'holding a large part of the cash reserves of the commercial banks, rediscounting of their bills, making collateral advances to them, operating as a clearing house for them, maintaining the monetary standard adopted by the state, and undertaking the responsibility and leadership in matters relating to the financial and credit structure generally.' As regards their dealings with the public in general, the practice varied from one bank to the other. On the one hand, there was the Bank of England which had almost given up this business, and on the other there was the Bank of France which dealt even with the smallest tradesmen of the country. In the present century, we have got certain rules and practices, and in their light central banking is treated as a special business. The Governor of the Bank of England appearing before the Hilton Young Commission pointed out the following duties of a Central Bank: "It should have the sole right of note-issue; it should be the channel, and the sole channel for the output and intake of legal tender currency. It should be the holder of all the Government balances; the holder of all the reserves of the other banks and branches of banks in the country. It should be the agent, so to speak, through which the financial operations at home and abroad of the Government

would be performed. It would further be the duty of a central bank to effect, so far as it could, suitable contraction and suitable expansion, in addition to aiming generally at stability, within as well without. When necessary, it would be the ultimate source from which emergency credit might be obtained in the form of re-discounting of approved bills, or advances on approved short securities, or Government paper."

M. H. De Kock, an eminent authority on Central Banking lays down more elaborate functions of a Central Bank which are summarised below :—

- 1 the issue of paper currency in accordance with the requirements of business and the general public, for which purpose it is granted either the sole right of note-issue or at least a partial monopoly thereof ;
2. the performance of the general banking and agency services for the state ;
- 3 the custody of the cash reserve of the commercial banks ;
4. the custody of the nation's metallic reserves ;
5. the re-discounting of bills of exchange, treasury bills and other suitable papers offered by the commercial banks, bill brokers, dealers and similar financial institutions ;
6. the acceptance of the lender of the last resort ;
7. the settlement of clearance balances between the banks ; and
8. the control of credit in accordance with the need of business and with a view to the maintenance of the monetary standard adopted by the state.

He also says that another requisite of a real central bank is that it must not, to any great extent, perform ordinary commercial banking transactions, such as accepting deposits from each and every one and accommodating a large number of regular commercial customers with discounts on advances. But it may be pointed out that a number of central banks, *e.g.*, the Bank of France, the Bank of Australia, the Bank of Java and the National Bank of Egypt do perform such transactions. In recent years it has come to be recognised that a central bank should not

undertake this business except when compelled to do so in the national economic interest and as such the banks mentioned above have also tended to curtail it or continue it only on the ground of some special need or circumstance. In Argentina and India, where the Bank of the Argentine Nation and the Imperial Bank of India respectively had been undertaking such business in addition to some central banking business, it was decided to establish special central banks with restrictions on their dealings with the public.

Let us now take up the functions enumerated above one by one, and examine them in detail.

(1) *The Issue of Paper Currency.* This function was almost everywhere one of the first functions to be entrusted to central banks. We know that the Bank of England has been performing it since its very inception. Some of the eminent writers on the subject regard it as the most important function of a central bank. All the central banks have at present either a complete monopoly or residue monopoly of it. It was pointed out in the previous chapter, when some of the important central banks got the residue monopoly. "In the case of most of those central banks which today enjoy a complete monopoly, the other banks performing this function, were at one time or the other required by law to redeem their issues as they were paid in, or to withdraw them from circulation within a fixed period. In others, the central banks themselves were required to take over these issues on certain conditions as to their redemption." In England, as has already been observed, the Act of 1844 allowed the private bankers to retain their note-issues but they were limited to the individual amounts of the average issues for the 12 weeks preceding April 27 of that year. A provision was also made to the effect that they would lapse under certain circumstances. In Germany most of the note-issuing banks had, owing to the restrictions placed on this business of theirs, surrendered it to the Reichsbank much before 1935, and those which had retained it till then were compelled to give it up in that year. "There are at present only a few central banks which do not enjoy a complete monopoly" of note-issue and of these only those

of the United States, Canada and China are important. In the United States the issues of the national banks lapsed in 1935-36 when they were redeemed, but there are still Government notes in circulation, though they form only a small portion of the total issue. In Canada also the notes of the chartered banks form only a small portion, while those of the central bank, namely, the Bank of Canada form the bulk of the circulation. But in China, the aggregate note-issue of the three non-central banks which issue notes was 1233 million Chinese dollars at the end of May 1938 while that of the Central Bank of China was only 473 million.¹ In India since July 1940, Government of India has also begun issuing one-rupee notes as a war measure in addition to the sole issue of the Reserve Bank of India, as the Treasury did in England during the last Great War.

The monopoly privilege of issuing notes has come to be regarded as an important constituent of the central banking structure for many reasons. First of all, it gives uniformity in respect of the note-currency which constitutes a very important part of the monetary circulation these days. Secondly, it gives the central bank vested with this power a special sort of prestige which is of great value in emergencies. Thirdly, it gives it some measure of control over the volume of credit which the commercial banks may manufacture. As will be seen later on they have to borrow legal tender currency from it or increase their balances with it, in case they wish to bring about an expansion of credit as they are required to maintain more or less a fixed percentage of cash reserve to it. The central bank may refuse to accommodate them, if it does not think it in the interest of the country to enable them to bring about its expansion. If it thinks otherwise, it may continue accommodating them and if necessary even give greater facilities for it. Finally, the Government is enabled to exercise its control over the note-issues with a view to ensure safety in a greater degree, if there is a monopoly privilege than if it is otherwise.

¹*Central Banking* by M. H. De Kock, page 22 (footnote).

Coming to the regulation of note-issues there are at least seven different methods for it. The first is what is known as the fixed fiduciary issue. It was adopted first of all in England in 1844. Under this method, notes worth a fixed amount are required to be covered only by Government securities, while all those issued in excess of it must be covered by metallic reserve. It is deficient in elasticity inasmuch as, whenever there is an appreciable internal or external drain of the metal, an undue contraction of currency and credit is rendered necessary. It is also not sufficiently adaptable to heavy demands for currency, as an expansion becomes impossible in case there is a shortage of the metal. But as against this, it may be said that it acts to a certain extent as a brake on undue expansion of currency and credit in times of prosperity. An element of elasticity was, however, introduced in the English system in 1928 when it was provided that the Treasury could authorise the fiduciary issue above £260 million to a special amount for not more than two years altogether from the date on which the authority was finally given. We know already how the figure of fiduciary issue was raised gradually from the original of £1,200,000 when the Bank was formed to £19,750,000 by 1921 when the last private banking firm's issue lapsed to it. But during the last war, the Treasury had issued £1 and 10s. notes and in 1928, the liability of this issue was also transferred to the Bank and the limit of its fiduciary issue was raised to £260 million. Since then, it has been raised and lowered several times.² The English system has been followed by Japan and Norway, and a variation of it has also been adopted by some other countries.

The second method is that of a fixed legal maximum of note-issue. It was followed by France from 1870 to 1928. Lemoine says, "It was altogether too rigid and incapable of sufficient adjustments to the requirements of the present-day money markets." It also provided no guarantee against inflation as the parliament could raise the limit at any time without any sufficient reason whatsoever.

²On July 18, 1945, its note circulation amounted to about £1301 million and bullion holding to about £1'242 million.

The third method is that where notes are required to be fully covered by Government securities, and in addition limited to the paid up capital and reserves of the issuing bank. It was formerly employed in the United States in the case of the national bank notes. Its shortcoming is that it does not provide for elasticity. As Burgess said under this method notes are so fixed that they can neither be decreased readily in slack seasons and dull years, nor increased in busy seasons and periods of emergency.

The fourth method is that where a small percentage say 25, 30, 33 $\frac{1}{3}$ or 40 of the total issue is to be kept in metallic reserve and the remainder is to be maintained in trade bills and Government securities with the further provision that subject to certain conditions and penalties the metallic reserve percentage may be allowed to fall below the statutory minimum. It was adopted in Germany in 1875 and with certain modifications in U. S. A. in 1913 with the introduction of the Federal Reserve system, and in various other countries after the last war. A great advantage of this method is that while it provides sufficient elasticity there is also a considerable guarantee against an undue expansion of the currency.

The fifth method is that where just like the fourth method a small percentage of the total issue is required to be covered by metallic reserve but for the remainder there is no specification of the particular kinds of assets which may be used as such. There is, however, a further provision under this method which makes the notes a first charge on all the assets of the issuing bank. It gives the bank greater freedom of action than is possible under the fourth method. It was in use in Holland for many years and is in use in the Union of South Africa even at present.

The sixth method is the proportional deposit method. Under this system, the issuing banks are required to deposit a fixed percentage of the amounts of the issues with the premier bank in gold or Government securities. This system prevails in United States, where member banks are required to invest a fixed percentage in securities and lodge them with the Federal Reserve Board.

The seventh method is a variation of the fixed percentage,

wherein a fixed amount is to be kept in the form of gold and the remainder in the form of the securities of some foreign governments or the balances with the premier bank of a foreign country. In India, there was fixed fiduciary method of note-issue from 1861 to 1920, and at present the fixed percentage-method is followed.

Finally, it may be mentioned that the state has practically everywhere claimed a share in the profits of the central banks in view of the fact that the monopoly of note issue enables them to earn huge profits. In some cases, the accounts of the profits made by these banks out of their note-issue business and banking business are kept separately and the state receives the whole of the profit arising out of the former business. In other cases, provision is made for a dividend to shareholders at a fixed rate as a first charge on the net profits and thereafter the whole goes to the state or else a division of the profits is made between the state and the shareholders on some statutory basis. In England, the whole profit arising out of the note-issue business of the Bank of England is handed over to the state; while in India, there is a provision for the payment of a fixed dividend of 3½% to the shareholders and the remainder goes to the Government.

(2) *The performance of the general banking and agency services for the state and acting as its adviser in financial matters.* The older central banks performed these services to the state even before they were recognised as central banks. In the case of the new ones, the performance of these services has been included in the preamble of the statutes which have brought them into existence. Now-a-days central banks render these services to the state, not only because it is more convenient and economical to the latter, but also due to influence of the public finance on the money market. The state is the largest receiver of revenue, and the biggest disburser of expenditure in any country, and unless the central bank acts as a banker to it, it cannot fulfil its duty and responsibility of controlling or adjusting credit in the national economic interest. In fact, it is because of its acting as banker, agent and adviser to the state, that the central bank can counteract distur-

bances to the money market caused by the receipts and payments of the Government. A central bank is also charged with the maintenance of foreign exchanges. State is usually the largest dealer in them and a central bank which deals in these on its behalf is enabled to perform this duty very successfully. The bank being in close contact with the money market is in a better position to advise the state on matters relating to finance as well in the interest of both.

In its capacity as the Government's banker, the central bank keeps the banking accounts of the various governments and departments, receiving all deposits of both capital and revenue nature, and making all such payments on its behalf. It also makes temporary advances to them in anticipation of the collection of revenue or the raising of loans from the public. A central bank does not, in fact, lend to the state permanently. No doubt, some central banks were started with the sole purpose of lending permanently to their Governments yet restrictions have so often been placed on their power to do so. We have read that the Bank of England was started with a view to lend £1,200,000, the whole of its initial capital to the state, and it made further advances from time to time till 1800 when its permanent loan had increased to £14,686,000. In 1833, this amount was, however, reduced to £11,015,000 at which figure it has remained ever since. From 1857, the Bank of France also began to grant permanent loans to the state and by 1926 these had reached the huge figure of £38 milliard³. In 1928, however, it was reduced to 200 million francs, the figure at which it had stood before the outbreak of the last Great War. This was effected 'partly out of a new long term loan raised from the public and partly out of the profit' resulting from the revaluation of the gold and exchange holdings of the Bank based on one-fifth of the former gold parity of the franc'. But a little later, it granted a further loan of 2 milliard francs. Again, beginning from 1935 and ending in November 1938, it had made provisional advances to the state to a total sum of 50 milliard francs. But by a convention concluded between the Bank and the State at this time the profit resulting from the revaluation of the former's gold

³Milliard=A thousand millions.

holdings at 170 francs to the £, was allocated towards part re-payment of the provisional advances and the permanent state debt to the Bank was raised from 3,200 million francs to 10 milliard francs. These are only two instances. Almost every central bank has granted permanent loans to its Government in periods of emergency. Restrictions always followed on further loans, which had to be withdrawn again and again. Besides granting such loans, central banks also purchase and re-discount Government securities and bills of considerable amounts. Two of the important central banks of the world, namely, the Bank of England and the Federal Reserve Banks of the United States of America have since the Great War of 1914—18 been in fact helping their respective Governments to a very great extent by this device.

It may, however, be pointed out in this connection that the creation of additional central bank credit through granting advances to the state also tends to bring about an arbitrary increase in the available supply of bank cash which might lead to inflation of credit in the same way as its issue of notes does. This happened during and after the Great War of 1914—18 in various important countries of the world. When the central bank makes an advance to the Government, the latter hands it over to the public either in exchange of their supply of goods or the rendering of services to it. These go to swell the bank deposits which in their turn increase their capacity to expand their investments, discounts and advances.

The Reserve Bank of India can make advances to the Government of the country to any extent but these must be repaid within three months from the date of the issue. But it can hold Government securities to the aggregate value of its share capital, reserve fund and three-fifths of the deposit liabilities of the Banking Department. But of these, those maturing after one year and those maturing after ten years should not exceed its capital and reserve plus in the order of mention two-fifths and one-fifth of the deposit liabilities of the Banking Department. The predominance assigned to short-dated securities is of course intended to save it from wide fluctuations in prices and ensure liquidity.

As the Government's agent and adviser the central bank is sometimes required to perform diverse functions. It manages the public debt, keeps transfer registers in respect of the stocks and certificates relating to it; floats, converts or redeems Government loans; issues and redeems Treasury bills; carries on exchange-clearings and does other sundry business.

(3) *The custody of the cash reserves of the commercial banks.* The central bank gradually became the custodian of the cash reserves of the commercial banks when the latter realised the advantage of keeping an account with the former particularly as it was the principal bank of issue, i.e., the bank whose notes commanded the greatest confidence and the widest circulation in the country. In fact, a balance with it served the same purpose as the money in their own tills. Moreover, they regarded it a matter of prestige to come in contact with the banker to the Government. The private banks of the eighteenth century England had realised all this and maintained their balances with the Bank of England. The joint stock banks too when they were established there, after 1826 continued the traditional practice. In other countries also the same happened. With the establishment of the Federal Reserve Banks in the United States a new principle regarding bank reserves was, however, introduced, namely, a statutory provision that commercial banks must maintain with the central bank certain minimum cash reserves against their deposit liabilities. This feature has been incorporated in the statutes of many central banks established thereafter. In our own country, as we have already observed in a previous chapter all the scheduled banks are by law compelled to keep a balance of at least five and two per cent of their demand and time deposits respectively with the Reserve Bank of India.

The centralisation of cash reserves whether laid down by law or governed by tradition is of great significance as far as the monetary and banking situation of a country is concerned. It forms a basis of larger and greater credit elasticity in so far as it can be put to work to the fullest extent possible during periods of seasonal strain and emer-

central banks learn by experience as to what is adequate or otherwise at a particular time and may be left to work according to their own requirements. In the beginning, when a new central bank is started there must, however, be some provision for the intervening period.

There are of course some countries which must keep huge amounts of reserves in order to be able to meet extraordinary demands of metal arising out of the peculiar circumstances in which they are placed. These may belong to any of the three categories:—(1) Those which have a predominance of few export commodities, e.g., Argentina, Brazil, Chile, Canada, Australia and New Zealand. In case their prices fall rapidly their balance of trade turns unfavourable and they are required to meet demands of the foreigners by exporting metal. (2) Those which possess a large volume of foreign short-term funds invested in them, e.g., Great Britain and U. S. A. These can be withdrawn at any time. (3) Those where there is a lack of confidence in the exchange value of the currency due to the intermittent political instability, e.g., France.

Before 1932 Bank of England kept only a small gold reserve. But after that it had added considerably to it whether against note issue or against Exchange Equalisation Fund. Since the outbreak of the present war, the same has, however, been lost. The Federal Reserve System of U. S. A. also keeps a huge stock of gold. Before passing on to another function of a central bank, it may be pointed out that some authorities regard the custody of various reserves as its characteristic function perhaps because several of these have been named reserve banks for instance, the Federal Reserve Banks of the United States, the South African Reserve Bank, the Central Reserve Bank of Peru, the Reserve Bank of New Zealand and the Reserve Bank of India.

(5) *The re-discount of bills of exchange, Treasury bills and other suitable paper offered by the commercial banks, bill-brokers and dealers and similar financial institutions and (6) the acceptance of the lender of the last resort,* Commercial banks, bill-brokers and dealers and similar financial institutions do not usually approach the central

bank for accommodation as long as they have not exhausted their own resources or failed to supplement them from those of outside. Hence, a central bank is known as a lender of the last resort, and as it acts as such mainly through its re-discounting operations; it is convenient for us to take both these functions, *i.e.*, (5) and (6) together. But it may be said here that even the Bank of England, while it performed the function of re-discount, was not prepared to assume the responsibilities of the lender of the last resort for a long time. As late as 1825, it confined its function of re-discounting at first to the bills of the type it had always been accustomed to re-discount. It was only at the end of that year when the holdings by the banks and other financial institutions of bills eligible for re-discount were exhausted that it made some relaxations and that too not ungrudgingly. In later crises also it showed much reluctance, but by the year 1873 when Bagehot's book, *viz.*, *Lombard Street* was published, it had begun to recognise unequivocally its responsibilities as such. All the other older central banks also followed practically the same process of evolution, and when the Federal Reserve Banks of the United States were established in 1913, the function had come to be regarded as a *sine qua non* of central banking. It is, in fact, this universal-development which went a good deal to impress upon several writers of repute including Hawtrey its importance to a central bank. The term re-discounting in the ordinary sense is applied only to first class trade and agricultural bills brought to central bank by commercial banks and other financial institutions which are temporarily in need of funds and want to convert some of their short-term assets into cash. But in the wider sense, it is applied also to Treasury bills and to short-term collateral loans to banks and other financial institutions against diverse securities. Truly speaking, this tendency towards a wider basis of re-discounts has grown out of the recognition of the responsibilities of the lender of the last resort, and scarcity of first-class trade and agricultural papers. In recent years, there has been a growing tendency towards overdrafts and open credits as the means of financing trade. Besides, the huge debts incurred by various Governments in connection with

the last two wars have resulted in enormous growth of government securities, in which commercial banks and other financial institutions keep their money ordinarily invested. In times of crises, therefore, only such securities can be offered to the central bank for forming the basis of its loans. "The function of re-discount is closely associated with the functions of note-issue and custody of cash reserves both of which when centralised in the central bank greatly increase the scope and extent of re-discounting. The privilege of note-issue enables the central bank to meet heavy demands for hand to hand currency, and the centralisation of cash reserves in the central bank gives it greater lending powers generally."⁵

But this facility should not be abused by the commercial banks. In normal times they must depend upon their own resources. Again, 'while a central bank should definitely regard it as an important part of its duty to help banks in distress and act as a lender of last resort, this does not imply that banks have an irrevocable right to unlimited accommodation from the central bank under all circumstances'. In India there has been a good deal of misunderstanding regarding it till recently, and the Reserve Bank of India was very much blamed for not giving accommodation to the Travancore National Quilon Bank when it fell in difficulty in the middle of 1938 and ultimately closed its doors. The position was made clear in the Bank's Memorandum, dated the 7th December, 1938, on "Discounts for and Advances to Scheduled Banks", which is as follows :

"In conformity with the usual practice of central banks in other parts of the world and with a view to promoting the development of banking on sound lines in this country, the Reserve Bank in extending its credit to the scheduled banks has to take into consideration not only the nature of the security offered to it but also the general character of the investments of the applying bank, the manner in which its business as a whole is being conducted, whether for instance it offers exclusively high rates of interest in order to attract deposits, whether it seeks help from the Reserve Bank in

⁵*Central Banking*, M. H. De Kock, page 108.

normal times when funds in the money market are ample and whether it has been overtrading and extending an undue amount of credit for speculative purposes in commodities or securities or indulging in unsecured business to an excessive extent. It is to be noted in this connection that the Reserve Bank is empowered by the Act to grant only temporary accommodation. With a need to ensuring that its credit facilities are not abused in any way, the Reserve Bank may call for such information or impose such conditions on the borrowing scheduled bank as it may consider necessary, and a scheduled bank requiring assistance from the Reserve Bank is expected to supply such information as may be called for.

Like any other bank, the Reserve Bank, of course, reserves the discretion to refuse to re-discount the paper of any particular bank without assigning a reason. But scheduled banks which run on sound lines may always expect to receive ready assistance from the Reserve Bank in times of emergency or stringency subject to their offering suitable security."

From this it is clear that a central bank can, in its capacity of the lender of the last resort, also bring the commercial banks of the country to a standard ordinarily required of them. In the United States of America also, the position was cleared by the Federal Reserve Bulletin of October 1937.

(7) *The settlement of clearance balances between the banks.* This function has been adopted by all central banks as a matter of course or as a duty laid down by law, the Bank of England in this respect too giving the lead. According to Sprague, it was in 1854 that the plan was first adopted by it. This was, in fact, a logical step for it after the assumption of the role of the custodian of the cash reserves of commercial banks. Other banks followed suit. By our experience, we find that the cheques, etc., drawn on any bank and presented by other banks on behalf of their customers for payment, over any period, tend to approximate closely the cheques, etc., on them received from its own depositors. The daily balances between these banks may, however, vary considerably, but these can be adjusted.

easily by means of debit and credit entries in their respective accounts in the central bank. In case the clearing goes heavily against a particular bank for sometime and its balance with the central bank tends to fall below the minimum required by law or maintained by tradition, it can re-discount with it and thus provide to make up the difference. The process is very useful. First of all, it facilitates settlements between different banks by means of a very simple operation, *viz*, making entries in the books. Secondly, it economises the use of money in these operations. Finally, it strengthens the banking system of a country by reducing the possibilities of cash withdrawals during a crisis.

In some of the countries where clearing arrangements had been made long before the establishment of a central bank by the commercial banks themselves or where the central banks did not take initiative in the matter in the beginning, there are of course independent clearing house institutions with constitutions and premises of their own. But there too the central bank apart from being its member has to perform also the function of settling the differences between banks at the end of each clearing. In others, however, it usually provides for clearing house accommodation, frames rules for the conduct of the operation, supervises it and finally performs the function of settling the differences as well.

In England, there are independent clearing houses in London and in eleven provincial towns, though in the former the Bank of England has got its office, and in the seven of the latter it has got its branches. The settlement is, however, effected through the Bank of England. In London, where it has an office, and in seven of the provincial towns where it has got its branches it is done by cheques drawn on them respectively. But in four towns, where there are clearing houses but no branches of the Bank, it is done between the head offices of the banks in London by cheques drawn on their accounts with the London office in the same way as the differences in the London clearings.

In India, there were autonomous clearing house institu-

tions at the more important places even before the establishment of the Reserve Bank, the conducting authority in them being naturally the Imperial Bank which managed all affairs on behalf of all the members. The Reserve Bank although empowered by section 58 (f) of the Act to frame rules for the regulation of clearing, has not found it necessary so far to frame any such rules, and clearing houses consequently, continue to retain their previous autonomous character even now. It has, however, taken the conducting authority of some of them on its shoulders. But there are, even now, two places, viz., Calcutta and Cawnpore, where in spite of having its banking office and branch respectively, it has left the conduct of this operation upon others. In the former, it is done by a supervisor appointed by the General Committee of the 'Clearing Banks' Association, and in the latter by the Imperial Bank of India. The members do, however, settle their clearing differences in all these places by means of cheques drawn on their accounts with the Reserve Bank of India only. There are places as well where the Reserve Bank has neither an office nor a branch, and hence in them Imperial Bank of India is not only the conducting authority but also the agency for the settlement of the difference thereof.

(8) *The control of credit in accordance with needs of business and with a view to the maintenance of the monetary standard adopted by the state.* This function is, in fact, the most important of all others. Shaw says in this connection, "The one true, but at the same time all suffering function of a central bank is control of credit." The main reason for this is that credit has come to play a predominant part in the settlement of monetary and business transactions of all kinds. It is said that almost 90 per cent of all payment in countries like Great Britain and U. S. A. are made by cheques instead of coins and notes. This being the case, credit has become a powerful force for good or evil, and hence requires control in the best interests of the country. Besides its issue or withdrawal, being essentially a banking function, its control should be vested in a bank rather than in a State department and in one bank rather than in a number of banks. Regarding the object of control, it may be said that there is a great difference of opinion.

The traditional object and the one which till recent years was the most predominant was that of keeping exchange rates stable. In the case of our own country, it applies even now. But stability of exchange rates does not necessarily mean stability of prices and often it was accompanied by severe fluctuations in them. If we give sufficient consideration to the question, we find that the stabilisation of prices is of greater importance than that of exchange rates. It is a matter of common knowledge that changes in the price level cause a host of changes and disturbances in the present day economic structure which in their turn bring about serious maladjustments with dire economic and social consequences. Besides, experience shows that the laying of greater stress upon the maintenance of stable exchange rates has often placed such countries at the mercy of one or more of the principal countries. This has been the case with India since her adoption of sterling exchange standard. The monetary policy of the country has always been based upon that of the United Kingdom, though the conditions in them have not always been identical with the result that the interests of the former had so often to be jettisoned. In contradistinction to the maintenance of the stability of either the exchange rates or prices as the object of the credit control, there is also the elimination or smoothing out of the business cycles. It is being held these days in an increasing degree that the maintenance of a normal and steady rate of growth in business activity and the prevention of booms or slumps should be its first aim, and every other, next.

As regards methods of credit control, we find different central banks using different methods at different times and sometimes they have to use more than one of them simultaneously. Of these, bank rate policy and open market operations are very important. We shall, however, take notice of them in a greater detail in the next chapter. But the extent to which a central bank can control credit in any country is dependent upon various factors. First of all, there is the stage of development of the money market and the degree of interdependence and contact between the central bank and the money market. The majority of countries do not have organised money markets. In our country

there are two money markets—indigenous and modern—without any relation between them. The indigenous market seldom seeks accommodation from the modern, and the modern, as we shall see later on, seldom seeks accommodation from the central bank of the country. Then, there is the proportion of commercial banks which are active members of the central banking system. Thirdly, there is the degree of co-operation between the central bank, and the commercial banks, and finally there is the moral influence of the central bank not only over the banks but also over other financial institutions. These vary in different countries. But the central banks can improve the conditions by adopting a policy to that end.

ITS RELATION WITH THE STATE -

In view of the importance of the functions performed by a central bank, it is necessary to say something of its relations with the State. In almost every country, the Government has found it necessary to control the activities of its premier bank in one way or the other. The tendency of the nineteenth century was somewhat to stress this in the very statutes. The World War I period, however, exhibited in an extreme degree its dangers, and since then the tide has changed. The Brussels Conference Resolution of 1920 to the effect that "banks and specially a Bank of Issue should be freed from political pressure and should be conducted solely on the lines of prudent finance" voiced the general feeling. Nevertheless, for obvious reasons, "most countries have recognised that the Government may reasonably have some influence in regard to the constitution of the governing body of the central bank"

First of all, there are some banks whose capital is entirely owned by the state, or jointly by the state and private shareholders, or the state and the commercial banks, or the state, the commercial banks and private shareholders. A controversy regarding the ownership of the Reserve Bank of India had also arisen as early as 1927. But in the end when it was established, the principle of private ownership had been firmly recognised. It may, in this connection, be said that the question of state ownership is not of any importance, since without it also,

the governments can exercise their control over the central banks in various ways. Then, the chief executive officers may be appointed by the Government either on its own initiative or with the advice of the Board of Directors or with the approval of the Legislature. Even if the state does not own the capital, it does not mean that it cannot participate in the appointment of the directors. In several countries including India, the governments appoint some of the directors, in spite of their not holding any shares in the central banks.

TEST QUESTIONS

1. 'Central banking as a specialised business has come into prominence only during the present century.' Comment on this statement.

2. What are the usual central banking functions? Is it essential that a central bank should not ordinarily undertake commercial banking functions?

3. What do you understand by a complete monopoly or a residue monopoly of issuing notes? When and how did the important central banks assume the complete monopoly of note-issue? Discuss the advantages of this privilege.

4. What are the different methods of the regulation of the issue of notes? Explain and illustrate each one of them.

5. What do you understand by the term 'a banker to the Government'? Are the central banks allowed to lend to their respective Governments? Show by means of illustrations how restrictions in this respect have been more than once violated.

6. Show how far the Reserve Bank of India can help the Government financially.

7. In what different ways the central banks act as custodians of the reserves of the commercial banks? Discuss the advantages of this function.

8. What form does the custody of the nation's metallic reserves with a central bank usually take? On what does the actual amount depend? Illustrate your answer by examples.

9. What is the relation between the functions of granting re-discounting facilities and acceptance, of the lender, of the

CENTRAL BANKING

last resort? Show how the latter function has been gradually evolved. What is the policy of the Reserve Bank of India in this connection?

10. What is the principle of 'clearing'? Discuss its advantages. What part does the central bank play with regard to it? Illustrate your answer by means of examples taken from the arrangement in England and India.

11. What do you understand by the term 'control of credit by the central bank'? What should be its aim? Mention two of the most important methods of doing it.

12. What is the usual relation of a central bank with its state? Illustrate your answer by means of examples.

CHAPTER VII

CENTRAL BANKING—(Continued)

Before the Great War of 1914-18, the principal method of credit control was the bank rate policy.

BANK RATE

Meaning and Implication. Bank rate is the rate at which a central bank is prepared to re-discount first class bills. It is fixed and announced every week on a particular day as a result of the deliberations in a special meeting of the bank directors, and except under most unusual circumstances, is not changed on any other day. At present, it is also the rate at which a central bank is prepared to make advances to its member banks on the basis of first class collaterals. The change has been made on account of the considerable shortage of bills and increase of Government securities and Treasury bills. The shortage of bills has been brought about by a number of causes, and the most important of them is the tendency of the commercial banks to grant overdrafts, cash credits and collateral loans in an increasing number to their customers. Then, formerly bills arose also out of the remittance business of the traders, but now-a-days it is not necessary. The number of commercial banks has been increasing and they perform almost the whole of this business by issuing bank drafts. All this is true of London in the same way as of other places. Besides, in London prior to the first world war, there was a considerable discounting of foreign bills, as it was the only international market at that time. But since then other places, and specially New York, have also developed such markets, consequently the discounting business has been divided between them. The number of foreign bills has also undergone a decline because of the impediments to foreign trade as a result of the protectionists' policy followed by different countries. On the other hand, the increase in Government securities and Treasury bills has been brought about by an increased indebtedness of the

Governments due to the world wars I & II and inter-war period difficulties.

Application as a Method of Credit Control. Bank rate policy, as a method of credit control, began to be applied first of all by the Bank of England in 1839. Prior to this bank rate was either 4 or 5 per cent. When the market rate of discount tended to fall, the Bank did not follow it below 4 per cent.; which resulted in its not getting any bills. But the absence of the Bank's competition soon brought the market rate of discount to 4 per cent which again brought the bills to the Bank. The Bank was also not empowered to raise the rate above 5 per cent owing to the operation of the usury law (this was relaxed in 1833 for bills of exchange up to three months' duration; and a few years later for bills of any currency). But this does not mean that it made no attempts to control credit. It adopted other methods *viz.* (1) that of the rationing of credit by limiting the amount available to each applicant, and (2) that of the shortening of the currency of bills eligible for discount. In 1839, bank rate was raised first to $5\frac{1}{2}$ per cent and then to 6 per cent. But along with this raising of the rate, there was also a reduction in the eligible currency for bills from 95 to 30 days. It was, however, after the passing of the Bank Act of 1844, that the bank rate policy began to be used as a method of credit control with an increasing force. And as the Bank gradually accepted the position of being the lender of last resort thereafter, other methods previously adopted by it were found to be quite incompatible with its duties and responsibilities in that capacity and had to be abandoned. In 1841, there was a crisis, and an opportunity was provided to the Bank to test the real strength of the new weapon, but for some time the authorities sat at rest, and when they raised the rate it was too late to be immediately effective. The Government had to intervene, and that part of the Act of 1844 which required the Bank to cover all notes issued beyond the fixed fiduciary limit by gold was suspended for a short period. But the necessity of its use did not arise at all. Its mere provision was enough to subside the panic. During the crisis of 1857 and 1866 also, it did not move hastily and raised its rate only when there was an

outflow of gold, and not when undue expansion of credit had begun to take place. Hence, on these two occasions as well provision had to be made for the suspension referred to above, and at the time of the former crisis, its use had to be actually made. But when in 1873 again, it had to face a difficult position, it moved hastily and successfully. During further crisis too it did the same and with success. In 1890, on the one hand, it raised its discount rate and thus put a check to the expansion of undue credit, on the other it undertook, in co-operation with other English banks and financial houses, to guarantee the payment at maturity of all obligations of the firm of Baring Brothers which had failed. This resulted not only in allaying public alarm but also enhanced the prestige of the Bank. But gradually newer methods of credit control such as 'borrowing from the London market, raising its buying and selling prices for gold within certain limits and arranging for or accepting credits from France and Russia, also began to be adopted with a view to control the credit,' though it may be safely said that the main reliance prior to the world war I and specially since the passing of 1844 Act was placed upon the bank rate policy. Other central banks also took advantage of the experience gained by the Bank of England in respect of its adoption for credit control. But nowhere it was employed to this extent and with this frequency. According to Loubet the Reichsbank (central bank of Germany) changed its discount rate 84 times between 1875 and 1900 compared with 167 times in the case of the Bank of England and 25 times in the case of the Bank of France. There were certain reasons for it. (1) London, being a free gold market, was regarded to be the best place for the investment of foreign capital, and as such when this capital was withdrawn as a result of complications and disturbances anywhere in the world, there arose difficulty. (2) The gold reserve of the Bank of England during this period was relatively small in comparison with the size of the British credit structure. (3) The investment of British capital in other countries resulted in a constant drain on the banking resources of Great Britain which in its turn resulted in a periodical tendency towards over investments, over expansion of pro-

duction and trade and over speculation. These could only be checked by raising the bank rate and sometimes very drastically.

Bank rate policy could be used as an effective method of control only on the assumption that the changes in the discount rate of the central bank would tend to bring about more or less corresponding changes in other money rates. A close relationship existed in England between different money rates. Bank rate was, thus, usually higher than the market rate of discount. This was, so to say, a penalising rate, and the market sought for accommodation from the Bank of England only after all outside sources had been tapped. But it was also the lowest rate at which the Bank was prepared to re-discount first class bills; for inferior classes of bills it charged higher rates. The rate charged by the Bank for collateral advances was also different from this. It was $\frac{1}{2}$ per cent above bank rate. Upon the changes in the bank rate depended the changes in the market rate of discount. The rate of interest allowed by the banks on deposits subject to seven days' notice was usually $1\frac{1}{2}$ per cent below the bank rate. In 1921 the margin was widened to 2 per cent. The call rate in turn was usually fixed at $\frac{1}{2}$ per cent above the deposit rate. With regard to the rate charged by the banks on advances to their customers, a margin of one per cent above the bank rate was usually maintained subject to minimum of 5 per cent. There were no doubt occasions when this rigid relationship was not followed, but ordinarily this was the practice. But in other countries, there was no such fixed relationship between the bank rate and other rates, and hence, the bank rate policy of the central banks in those countries did not prove to be a so very effective weapon for the control of credit. The factors upon which the extent of the credit control of a central bank depends have been already discussed¹ and it has been observed that in none of the countries except England they could be found to perfection.

When the Federal Reserve Banks began operations

¹ See Chapter VI.

in 1914, they tended towards the adoption of the Bank of England's technique of credit control and took an active part in promoting the establishment of a well-developed money market in New York. They were no doubt successful, but the relationship between bank rate and other money rates was set up there a bit differently as compared with London mainly due to different conditions. In Great Britain, banks did not seek accommodation from the Bank of England directly. What they did at the time of stringency was that they called up their loans from bill brokers and others and refused to discount their bills. This naturally compelled the market to approach the lender of the last resort which dictated its own terms. In contrast to this in the United States the member banks dealt directly with their Reserve Banks. Next, while the bank rate in the former was the lowest rate at which accommodation could be obtained from the central bank, it was not so in the latter. 'Apart from the discount rate the Federal Reserve Banks quoted a buying rate for bankers' acceptances dealt with in the open market, and this rate was naturally lower than the discount rate and frequently as low as the market rate for the purpose of assisting and maintaining a bill market.' Hence while the member banks got accommodation from the Reserve Banks by discounting commercial papers at a higher rate, the market obtained it by discounting bankers' acceptances at a lower rate. The result of this was that the bank rate policy could not be adopted as a method of controlling credit there as it could be adopted in Great Britain. Thirdly, during the greater part of the career of the Federal Reserve Banks, there was a surplus of gold reserves in the United States, and this could be used as a basis for the expansion of currency. To these may be added also such factors as the wide scope and strong inclination for speculative activity and the lack of independence on the part of the Federal Reserve Banks in the matter of fixing bank rate. There are instances of the declining of the Federal Reserve Board to sanction the increase of the bank rates proposed by the Federal Reserve Banks at various times.

During and for various periods after the world war I, the central banks could not follow bank rate policy, as they

had to act in the interest of the financial requirements of the state. But as soon as the international gold standard was restored, and the central banks were freed to act in their own way, the bank rate policy began to be adopted again with a view to control credit, though its importance as such tended to decline relatively to other methods of credit control, *e.g.*, open market operations, moral suasion, etc. We have already observed² the causes of the shortage of bills, and also the fact of the central banks' having extended the application of the bank rate to the loans on the basis of Treasury bills and Government securities. But this did not help them for long as certain other conditions had changed and was changing considerably. The important money markets were in an abnormally liquid state, mainly due to an enormous increase in their stocks of gold whether held by their central banks or by the State Equalisation or Stabilisation Accounts. The influence of the Treasury on the money markets as compared to that of the central banks had also greatly increased due to an increase in the amounts of Treasury bills outstanding at a particular time. Besides, since the world-wide suspension of the gold standard, managed currency has been adopted, and not only this but also a sort of planned economy is being followed these days in almost every country in place of a natural economy which provided for a substantial measure of elasticity to prices, wages, production, and trade and thus allowed them to respond to changes in money rates and credit conditions. Wagemann says "Bank rate policy presupposes an economic system in which the price, wage and interest levels—at least in greater part—are readily movable." But these are not readily movable under a system of managed currency and planned economy and hence the bank rate policy too cannot be effective.

But in spite of this, bank rate is quoted week after week by almost every bank. In many cases their statutes actually contain a provision to the effect that they must fix and publish it. This shows its importance even in these days. First of all, it indicates the rate at which credit can be obtained from the central bank on the basis of

²See Chapter VI.

certain types of paper. Secondly, it serves to give an idea as to the level at which credit should be made available in general. And thirdly, it is a reflection of the central bank's opinion of the credit situation and sometimes of the general economic position in a country. In the words of Gibson, a rise in it may be regarded as the amber-coloured light of warning of a robot system of finance and economics. To quote Addis 'the same is a danger signal, the red light warning to the business community of rocks ahead on the course in which they are engaged.' While a fall in it may be looked upon as 'the green light indicating that the coast is clear and that the ship of commerce may proceed on her way with caution.'

APPLICATION OF THE OPEN-MARKET POLICY AS A METHOD OF CREDIT CONTROL

It has already been observed that along with the bank rate policy, Bank of England had begun to apply other policies also for the purpose of the control of credit even before the world war I and post-War period. Out of them, open market policy continued to get greater and greater prominence, and at present instead of being adopted merely as a subsidiary and complementary method to that of the bank rate policy, it is being adopted as an independent method. This policy implies in fact the purchase or sale by the central bank in the market of any kind of paper in which it deals, whether Government securities or other public securities or bankers' acceptances or trade bills. But in practice central banks make purchases or sales of only Government securities—both long term and short term. Other public securities are for obvious reasons disregarded by them, and this has been made possible as a result of the enormous increase in the state floatation of loans, both long-term and short-term since the first Great War. The principal reason for using this term for these purchases and sales is that in this case it is the central bank which goes to the market, and not the market which goes to the central bank.

But this policy may be effective only under certain conditions. First of all, it presupposes that banking habit is considerably developed in the country and that there

is no surplus money lying in hoards, which may be used for the purchase of the securities when they are sold by the central bank. The effect may also be counter-balanced if the securities are purchased by the foreigners who send gold in exchange for them. Secondly, it is necessary that any increase or decrease in the cash or bank balances of the commercial banks must have its repercussion directly on their manufacturing of credit. There are many circumstances when commercial banks are deterred from employing increased cash or bank balances for the manufacture of credit or *vice versa*. Thirdly, it is not only the question of the willingness of the commercial banks to act in the desired direction, it is also the question of the preparedness of the entrepreneurs to take the risks and the availability of the reliable borrowers. In the absence of both of these an expansion of credit does not take place in spite of the willingness of the banks to do so. Conversely, the prospects of business and speculation may appear so attractive to the entrepreneurs that the banks may not be able to reduce their demand for credit even if they try to do that. Finally, there is the need of the velocity of the bank deposits to remain constant. Ordinarily this velocity tends to increase during periods of rising business activity and decrease during those of declining business activity. However, in practice none of these conditions are found in existence to the full extent in any of the countries. But normally, open market policy is considerably effective in at least the most important countries these days. The significance of the open market policy is that its operations tend to increase or decrease the supply of bank cash and that such changes ordinarily tend to bring about changes in money rates and credit conditions which in their own turn bring about corresponding adjustment in the price level and general business activity. If there is a break anywhere, the desired effect is not obtained.

Speaking about this policy as far as London is concerned, Crick, a London bank economist says that "the Bank of England can and does act forcibly and deliberately to bring about, by direct action on cash reserves, either an expansion or contraction of bank deposits and as such controls credit." The main objectives of this policy by

the Bank of England have been summarised by M. H. De Kock in the following lines :—

(1) to make bank rate effective or to prepare the ground for a change in the bank rate ;

(2) to avoid disturbances in the money market as a result of movements of Government funds or seasonal movements generally ;

(3) to offset the inflow and outflow of gold ;

(4) to support Government credit in connection with the issue of new loans or the conversion of existing loans ; and

(5) to create and maintain conditions of cheap money as an aid to business recovery. The same may be said of the objectives of the open market policy of the Federal Reserve System of the United States, though with important differences in degree or emphasis and in the scale of operations.

The Reserve Bank of India too has been given the power to undertake open market operations if necessary and the conditions upon which the extent and effectiveness of these depend have also been sought³ to be created as far as possible. But so far, there has not arisen any occasion for it to undertake these open market operations.

APPLICATION OF OTHER METHODS OF CREDIT CONTROL

A mention of some of these has already been made in connection with the discussion of the bank rate policy method. It has already been mentioned that prior to 1839, the Bank of England adopted the methods of (i) rationing of credit by limiting the amount available to each applicant and (ii) the shortening of the currency of bills eligible for discount, and in this year, along with the adoption of the bank rate policy, it adopted the second method also and actually reduced the currency of eligible bills from 95 to 30 days. It was also pointed out in the same connection that the bank followed gradually newer methods such as borrowing from the London market,

³ See chapter on the Reserve Bank of India.

raising its buying and selling prices for gold within certain limits and arranging for or accepting credits from France and Russia. In recent years some more methods have come in vogue. But before dealing with them we must, first of all, take up the method of the rationing of credit once more, as it appears to have acquired considerable favour by the authoritarian states. In fact, it is, in a large measure, a logical concomitant of national planning schemes adopted by them.

Rationing of Credit. Germany adopted this method in 1924 in order to save the newly stabilised Rentenmark from going down. It adopted the same in 1929 as well, "when the Paris negotiations in connection with the Young Plan led to the withdrawal of the money from the country and to attacks on the home currency. A further occasion for its adoption arose in 1931 when Reichsbank prevented the collapse of large banks by fixing credit quotas. In Russia, this method has become an important factor in general economic policy of the State Bank. Katzenellenbaum points out that the bank rate of the central bank 'is neither an index of the supply and demand of loan funds nor a regulator of such supply', but that 'the State Bank is guided by another principle in regard to the investment of its inflowing funds, namely, the allocation of funds among financially sound credit aspirants in accordance with a definite plan,' and that 'at times when the demands for credit exceed the State Bank's available resources . . . the State Bank is obliged to divide these funds in some definite way among the enterprise which have need of them.' During world war II, this method was used by democratic governments as well.

Direct Action and Moral Suasion. Direct action may be taken to include moral suasion, but M. H. De-Kock has tried to draw a line of distinction between the two. According to him the former is said to embrace "only those cases where the central bank decides or is compelled to take coercive measures against a commercial bank" while the latter "is applied to those cases where the central bank endeavours to achieve its object by making suitable representations to the institutions concerned and relying on its moral influence and power of

persuasion". These methods have been used in one form or the other at various occasions by central banks "either as alternatives to discount rate policy or to open market operations or in conjunction with them." In the United States of America when Federal Reserve Board refused to sanction increases in the bank rate and specially in 1928-29, it pointed out these methods as alternatives to the proposal, but on the authority of Clark, it may be said that the experience of the Federal Reserve Banks with them has been of such a nature that they may be regarded only as of limited value and should be used with caution. They have been employed by Reichsbank also on various occasions, and perhaps with a greater success. But this was due to the threatenings of drastic action which are only possible to be resorted to only in an authoritarian state.

Changes in Minimum Cash Reserves of Commercial Banks. It was noticed during the course of the discussion of the cash reserves of commercial banks in Chapter V that in several countries there is a provision for keeping a fixed percentage of the demand and time liabilities with the central bank. In recent years central banking authorities have used the power of increasing or decreasing this limit. It was first introduced in the United States in 1933 and amended in 1935. The Act gave power to the Board of Governors of the Federal Reserve system to change the member banks' reserve requirements by regulation "in order to prevent injurious credit expansion or contraction". In August 1936 it was brought into use for the first time. The reserve requirements were raised by one half. The Board of Governors said at this time, "it is far better to sterilise a part of these superfluous reserves while they are still unused than to permit a credit structure to be erected upon them and then to withdraw the foundation of the structure". The excess reserves of the member banks, however, again increased, as the continued inflow of gold had not abated, and hence, the Board of Governors, in the beginning of 1937, had to decide once more to make a further increase in reserve requirements in two instalments, and this brought them to double the minimum reserves existing before August 1936. In April, 1938, however, the minimum reserves were reduced by $12\frac{1}{2}$ per cent from their

new high level. Other countries which have used this method recently are New Zealand and Sweden.

No doubt, this method is a most useful addition to other methods of credit control, but at the same time, it has got certain limitations. First of all, it may be pointed out that the reserves of all the banks do not increase or decrease simultaneously and to the same extent, and hence, its uniform increase or decrease in the requirements laid down by the central banking authorities may have different effects upon different banks. Secondly, this method can bear the desired fruit only when those conditions exist under which the method of open market policy can be effective.

Changes in Margin Requirements of Security Loans. The Securities Exchange Act of 1931 provides to Federal Reserve system with a further instrument of credit control, viz., to make changes in margin requirements of security loans. As is obvious, this has been designed to assist the banks in controlling the volume of credit used for speculation in securities. In 1936, the Board fixed a margin requirement of 55 per cent for loans by banks or brokers to their customers for the purchase of stock exchange securities. Then, in November 1937, it was reduced to 40 per cent. During World war II it has been used in several other countries.

Publicity. All the central banks publish various periodical statements, reports and miscellaneous literature in one form or the other. But nowhere has this been used so much with a view to control credit as in the United States. Burgess holds that the statements of views of officials of the Federal Reserve system "have sometimes constituted an instrument of policy fully as effective as specific action which might be taken". The Reichsbank has also made a considerable use of this instrument.

CENTRAL BANK'S POWER TO ELIMINATE BUSINESS CYCLES

It was pointed out in the last chapter in connection with the credit control function of the central bank that one of its objects is also the elimination or smoothing out of business cycles and that it is being held these days in an increasing degree that the maintenance of a normal and steady rate of growth in business activity and the

prevention of booms or slumps should be the first aim and every other next. Before taking up the success or otherwise of the central banks to achieve this end, we must first of all understand what we mean by the terms 'business cycles,' 'booms' and 'slumps'. The term 'business cycles' has been derived from the cyclical nature of fluctuations in business activities. Wesley Mitchell defines a business cycle 'as any single succession of expansion and contraction of business activity, *i.e.*, between one period of prosperity and another, or between one depression and another, irrespective of whether the transition from prosperity to depression is of the nature of a crisis or merely a mild recession'. On this basis M. H. De Kock holds it to consist of four successive phases, *viz.*, prosperity, recession, depression and revival. Of these, prosperity period goes by the name of boom period and that of depression by the name of slump period. As regards the causes of this tendency, they are both monetary and non-monetary and as far as monetary causes are concerned they can be held in control by the banks to some extent if not to the fullest extent. After a period of expansion and prosperity, recession or crisis is brought about only because of excessive speculation. To quote M. H. De Kock again, "in a period of prosperity and expanding activity a spirit of optimism and enterprise naturally prevails. At such times profits are easily made in business and to make still greater profits the business community seeks to increase its turnover and call upon the banks for increased accommodation. As a result of such constant pressure, banks may be induced to extend credits more freely to manufacturers and merchants who in turn are encouraged by the evidences of prosperity to extend credit more freely to their own customers. Under such conditions of easy and excessive credit the ratio of business turnover to capital and the volume of trade and production of consumers' as well as capital goods tend to grow more rapidly as time goes on. In due course speculative activity becomes intense and a boom psychology prevails. The process of increasing profits, expanding trade and production, growing speculative, activity, and rising prices of land, commodities and securities cannot continue indefinitely however; sooner

or later, the tide must turn, when the opposite tendencies are set in motion and prevail until they have spent their force". This speculative activity must be checked, and no doubt banks have no means to bring about a change in the psychology to a very great extent, yet, they can check the people from giving bent to it at least to some extent by withholding credit for such purposes and thus eliminate recession. Sykes has drawn three important points from his analysis of the steps leading to a recession or crisis, *viz.*, (1) there must be a speculative spirit abroad, (2) speculation acts by means of its effects upon prices, and (3) speculation acts upon prices by means of an increase in credit, and says that banks can "by controlling credit control prices and hence speculative activity and thus eliminate recession. And, as a central bank is a leader of all the banks, it can always look to their general tone and give them warning and help such as take heed of it in case they fall in trouble.

TEST QUESTIONS

1. What do you understand by the term 'bank rate'? What has led to change in its nature in recent years?
2. Show how bank rate policy assumed greater and greater importance as a method of credit control in England and other countries in the nineteenth century. Why is it that it has lost its ground since the Great War of 1914—18?
3. What was the relation between the bank rate and other rates in the London money market? In what ways did the bank rate of the Bank of England differ from those of the other central banks?
4. 'Bank rate policy as a method of credit control was neither so very effective nor resorted to with such frequency in other countries as in England'. What was the reason for it?
5. What do you understand by the term 'open market operation'? On what does its successful adoption depend as a method of credit control? Explain yourself clearly.
6. Write short notes on the following methods of credit control :—(1) rationing of credit, (2) shortening of the currency of bills eligible for discount, (3) direct action, (4) moral suasion,

(5) changes in minimum cash reserves, (6) changes in margin requirements, and (7) publicity.

7. What do you understand by the terms 'business cycles', 'booms' and 'slumps'? Has the central bank power to check business cycles?

CHAPTER VIII

CREDIT AND CREDIT INSTRUMENTS

Modern commerce as also the modern large scale production have been made possible by the use of credit and credit instruments. In the words of Macleod, "What the steam engine is in mechanism : What the differential calculus is in Mathematics : that is credit in Commerce."

WHAT IS CREDIT ?

Credit in its literal sense means trust or confidence. Actual y it means the postponement of payment. *It may be defined as an exchange which is not complete until a certain period of time has expired.* Credit involves three essentials, viz., (1) exchange or transfer of value, (2) time, and (3) confidence—confidence both in the integrity and capacity of the borrower.

Nature. Since the industrial revolution, credit has been assuming such importance that some people are inclined to regard it as real wealth, true capital, and a factor of production. In order to decide whether this is so, we must find out if credit alone, without the help of anything else, is capable of satisfying human wants, which is the chief characteristic of wealth. And if the answer is in affirmative, we must further find out if it can be used for production, as wealth used for production is capital. It is on the basis of these findings that we shall be able to decide finally if it is a factor of production. First of all, credit is not wealth in itself. Howsoever confidence we may have in some one, this confidence alone will not enable him to raise capital, if none has got some wealth to give him. But as we have already seen, banks grant credit far in excess of the money they possess. In so far as this happens there are people who say credit is certainly wealth. But the fact is that this multiplied wealth has for its basis some real wealth without which it could not have come into existence. We can, then, say that *credit multiplies*

wealth and when the same is used for production credit gives it the form of capital. In short, credit makes wealth more useful. It is not, therefore, a factor of production, but a method of production. It makes capital more efficient in the same way as Division of Labour makes labour more efficient.

Forms. Credit has various forms, e.g., commercial credit, bank credit, public credit, industrial or capital credit, individual or personal credit. When merchants buy commodities on the basis of their credit, it is known as commercial credit. But this credit is very limited in scope and soon terminates. In order to extend its area and time, it must be exchanged with bank credit. Bills of exchange represent commercial credit. Their circulation is limited. But as soon as they are exchanged with bank credit—notes and other instruments like bankers' acceptances and letters of credit—they can be circulated over a much wider area. There are only some persons who know a particular merchant, and he cannot buy goods on credit from others on his own credit. But as soon as he gets it exchanged with bank credit, he can buy goods. The bank allows him to draw cheques and bills. The latter are usually allowed to be drawn by the creditors of the merchants, and we have already seen enough of them in Chapter V under the heading of acceptance business. Public credit means the borrowing operations of Governments by means of interest bearing securities. Capital or industrial credit refers to the borrowing of finance by industrial concerns. Individual or personal credit refers to the obtaining of individual goods and money for consumption on credit. These credits may be obtained either by means of credit instruments of which we shall study in detail subsequently, or by means of book entries. In the latter case, it is known as book credit.

Advantages. Credit gives rise to credit instruments which serve the purpose of metallic currency. They (a) constitute a cheaper medium of exchange than metallic money, (b) are more convenient to handle, and (c) fill up the shortage of metallic currency which alone cannot fully meet the requirements. These instruments set free

much of the precious metal which can be put to other uses. They make the transmission of money cheap to distant places. Settlement of foreign payment is much facilitated through them.

Credit also makes possible the collection of unspent incomes of the people. The habit of thrift is thus inculcated in masses. This collection, in its turn, is placed at the disposal of those who are best fitted to use it for further production of wealth. The vast production that has been going on all round us has been possible only by credit.

Credit minimises price fluctuations as well. Banks, known as coiners of credit, coin it whenever there is a need for more currency, and destroy it as they find that it is redundant.

Governments are enabled by means of credit to tide over financial stringencies. They carry on prolonged wars with its help.

Finally, credit helps individuals in times of hardship when they are temporarily short of funds.

Disadvantages. Credit which is the source of so many benefits and advantages is also attended by some dangers. The liability of its over-issue is its greatest evil. When such is the case, it leads to excessive zeal, over-production and speculation. It also enables a man of doubtful ability to start a speculative and unprofitable business, not only to ruin himself but also others. Consumers in a position to obtain credit, obtain it only to become financial wrecks. It has given rise to capitalism with its resultant evils, *e.g.*, competition and exploitation of labourers.

CREDIT INSTRUMENTS

Credit has given rise to numerous credit instruments. It is impossible to deal with all of them. We shall make an endeavour to explain them under the headings (1) Negotiable instruments, (2) Hundis and (3) Miscellaneous Credit Instruments.

Negotiable Instruments

They are a cheque, a bill of exchange and a promissory note. Their chief characteristics shall be discussed in the

next chapter. But their negotiability can be restricted or excluded by restrictive endorsements or in the case of a cheque by crossing it 'Not Negotiable'. A restriction or exclusion of this characteristic does not, however, mean a restriction or exclusion of transferability. The difference between transferability and negotiability must be clearly understood. An instrument having no negotiability or whose negotiability has been restricted or excluded may be endorsed any number of times, but if it happens to be stolen or acquired by some other improper means and transferred *for value* by such a person to a third party, it does not give the third party better title than that of the transferor, (who had stolen or acquired by improper means) and has to be returned to the true owners. On the other hand, a negotiable instrument whose negotiability has not been restricted or excluded, confers on the person giving value for it the right to retain it even against the true owner from whom it was stolen or required in an improper manner. In short, transferability does not give absolute ownership, but negotiability does.

Cheque. A cheque has been defined in Sec. 6 of the Indian Negotiable Instrument Act as 'a bill of exchange drawn on a specified banker and not expressed to be payable otherwise than on demand.' It will thus be seen that it has three essentials, *viz.*, (1) it should answer the definition of a bill of exchange, (2) it should be drawn on a banker and (3) it should be payable on demand.

Bill of exchange has been defined in Sec. 5 of the same Act as "an instrument in writing containing an *unconditional order*, signed by the maker, directing a certain person to pay a *certain sum of money* only to, or the order of a *certain person*¹ or to the bearer of the instrument."

¹In the above definition the words italicised have a particular meaning. It has been laid down in Section 5 that (1) "A promise or order to pay is not conditional" within the meaning of this section and section 4 (this relates to a promissory note) by reason of the time of payment of the amount or any instalment thereof being expressed to be on the lapse of a certain period

Keeping these definitions in view we may say, 'A cheque is an unconditional order in writing drawn upon a specified banker signed by the drawer, directing the banker to pay on demand a sum certain in money to or to the order of a person named therein or to the bearer, and which does not order any act to be done in addition to the payment of money.'

Though every word in the above definition of a cheque is important, we find the following salient points on analysis :—

(1) It must contain an order :—

(2) (a) The order must be unconditional ; (b) must be in writing ; (c) must be addressed to a particular bank ; (d) must be signed by the drawer ; and (e) must require the payment to be made on demand. No time is given.

(3) The amount ordered to be paid must be a sum certain in money.

(4) Payment must be ordered to be made to a person named therein or his order or the bearer of the instrument.

(5) No other act is required to be done except that of the payment of money.

The parties to a cheque are (1) the drawer, *i.e.*, the person who draws the cheque, (2) the drawee, *i.e.*, the banker and (3) the payee, *i.e.*, the person named in the cheque to whom the money is to be paid.

It has already been observed that in case the payee

after the occurrence of a specified event which according to the ordinary expectation of mankind is certain to happen, although the time of its happening may be uncertain," (2) "the sum payable may be 'certain' within the meaning of this section and section 4, although it includes future interest or is payable at an indicated rate of exchange, or is according to the course of exchange and although the instrument provides that, on default of payment of instalment, the balance unpaid shall become due and (3) "the person to whom it is payable or to whom the direction is given for payment, is certain within the meaning of this section and section 4, although he is misnamed or designated by description only."

is a fictitious or non-existing person, the cheque may be treated as payable to bearer.

Just after the name of the payee, there are the words 'bearer or order', and any one of them has to be struck off. In case, a cheque is *bearer*, it may be paid to anybody presenting it. If on the other hand, it is *order*, it must be paid either to the payee or to his order only. As has already been observed, such a cheque requires an endorsement. In case, both the words 'order' and 'bearer' are cancelled, or the word 'only' is added after the name of the payee, the cheque is to be treated as order. We already know that endorsement implies negotiation, but in case a cheque is payable to the payee only it implies only transfer.

All cheques are required to be drawn in local currency because the banker is not bound to honour them if drawn in foreign currency. He may honour the latter, if he wishes, at the rate of exchange ruling at the time of presentation.

CHEQUE FORM

No. 135	No. 135	Dated July 15, 1941
Dated.....	ALLAHABAD COMMERCIAL BANK, LTD., ALLAHABAD.	
In favour of.....	Pay	Mr. Ram Prasad <u>order</u> <u>bearer</u>
.....	Rupees One hundred only	
Rs.	Rs. 100/-	G. Dayal.

Cheque form consists of cheque proper and counterfoil. The latter remains in the book for future reference, and the former is handed over to the payee.

While writing a cheque both the foil and counterfoil should be filled in. First of all, there is the date. It should be filled in correctly as a post-dated cheque will not be paid

by a banker before the arrival of the particular date and an ante-dated cheque will become stale, if it bears a date which is six months or more prior to the date on which it is presented. If no date is given, the banker can put down the correct date, but generally he will return it marked incomplete. After this, there is the name of the payee. This must clearly be given in the body. If there is any doubt regarding the spellings of a particular name, it should be ascertained. If money is drawn for self, the word 'self' may be used. In most of the cheque forms both the words 'bearer' and 'order' are printed. One of these should be struck off. Next, comes the amount. It is to be given both in words and figures. Care should be taken not to leave blank space at places where there is a possibility of any forgery. The amount in words and figures must tally. Finally, there is the signature. It should not differ from the one given in the autograph book of the bank at the time of the opening of account. Undoubtedly, an order cheque affords a better protection to the holder than a bearer cheque. But there are certain other devices for it. Instead of striking off only one of the words out of the 'bearer' and 'order', both may be struck off and the word 'only' may be added to the name of the payee. This has the effect of making the instrument not negotiable. It may also be crossed generally or specially. A cheque not crossed is known as an open cheque. Within the crossings, the words 'not negotiable' may as well be written. Sometimes the words, 'Account payee only' are also added. It is a direction to the collecting banker that he should place the amount of the cheque collected by him to the credit of the payee's account and that he should not pay cash for it at the counter of the bank. All this may be done by the drawer himself or any of the subsequent holders. Where a cheque is specially crossed, the banker to whom it is crossed may again cross it specially to another banker, his agent for collection.

The holder of a cheque must present it to the drawee bank for payment either personally or through a bank within a reasonable time, as otherwise he runs the risk of losing his claim against the drawer and parties prior to him

if the drawee bank becomes insolvent in the meantime. In such a case, he ranks as one of the creditors of the bank and may be paid only a composition at the time of the settlement.

The *holder of a cheque* as of a promissory note and a bill of exchange also, according to Section 8 of the Negotiable Instruments Act means 'any person entitled in his own name to the possession thereof and to receive or recover the amount due thereon from the parties thereto. Where the note, bill or cheque is lost or destroyed, its holder is the person so entitled at the time of such loss or destruction,' and he has got the right to apply to the drawer for a fresh note, bill or cheque of the same tenor giving security to him with a view to indemnify him against all persons whatsoever, in case the note, bill or cheque alleged to have been lost or destroyed, should fall into innocent hands and the drawer should thereby suffer a loss. When an instrument of credit is sent through post as a remittance, and is lost, the loss would fall on the sender if it was sent on his own responsibility, *i.e.*, without the authority from or request of the creditor. If it was in accordance with the instructions of the creditor the loss would naturally fall on him.

A *holder in due course*, again, in accordance with the Negotiable Instrument Act means 'any person who for consideration became the possessor of a promissory note, bill of exchange or cheque if payable to bearer; or the payee or endorsee thereof if payable to order, before the amount mentioned in it became payable, and without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title'. Three things are necessary here, *vis.*,

- (1) Receipt for consideration;
- (2) Before the amount mentioned in it became payable; and
- (3) Without having sufficient cause to believe that any defect existed in the title of the person from whom he derived his title.

Its old English equivalent was "*bona fide* holder for value without notice". This phrase, though long and cumbrous, is self-explanatory.

A *marked cheque* is one which is signed by the drawee banker signifying that on the date of presentation of the cheque for signature, he had sufficient funds to meet it. It may be done at the instance of the drawer, another banker or the holder. It is doubtful how far the drawee banker binds himself to earmark funds to meet a marked cheque.

Bill of Exchange. The definition of a bill of exchange has already been given. It has the same parties as a cheque, the only difference being that the drawee in this case need not necessarily be a banker as in the case of a cheque. It is of two kinds—inland and foreign. An inland bill of exchange is drawn or made in one country, and made payable in, or drawn upon any person resident in the same country. A foreign bill of exchange, on the other hand, is not so drawn, made or made payable.

SPECIMEN OF AN INLAND BILL

2 as.	Rs. 700/-	Delhi.
		October 29, 1941.
One month after date, pay to B. Shiam Lal		
or order the sum of Rupèes Seven hundred only, value received.		
To	Jharamal Panna Lal-	
	Bhuramal Ram Gopal,	
	15, Katra,	
	Allahabad.	

SPECIMEN OF A FOREIGN BILL

First of Exchange

2 as.	£ 40.	Delhi.
		October 29, 1941.
Ninety days after sight of this First of		
Exchange (second and third of the same tenor and date		
unpaid), pay to the National Bank of India, Ltd., the sum		
of pounds Forty only, value received.		
To	Madhuridas Narain Das-	
	Messrs. John Anderson,	
	Parker Street,	
	London.	

While writing a bill, the following should be borne in mind :—

1. **THE DATE.** It must be the same on which the bill is written. The given tenor is added to this date in order to arrive at the date of maturity.

2. **TENOR OR TERM.** It is the period for which a bill is drawn, e.g., 3 months after date (3m/d) or ninety days after sight (90 d/s). This must be stated in clear words. After the expiry of the term, as has been observed, the bill matures for payment. Some days of grace, usually three, are allowed to the acceptor to redeem the bill. Hence, in order to find out the exact date of payment both the period of tenor and days of grace must be added to the date of the bill. Further, if the day, on which a bill as also a promissory note is at maturity, is a public holiday, the instrument shall be deemed to be due on the day preceding this holiday. The expression public holiday includes (1) Sundays, (2) New Year's day, (3) Christmas day, (4) Good Friday and (5) any other day declared by the Local Government by notification as public holiday. If either New Year's day or Christmas day falls on Sunday, Monday is also a public holiday, and the bill falls due on Saturday. In English Law there is, however, a difference between a public holiday and a bank holiday; in the case of the latter the instrument is payable on the following business day. But there is no such distinction in India which the students will bear in mind. A bill may also be a demand bill which must be paid on demand. No days of grace are required to be allowed in this case.

3. **AMOUNT.** It must be given twice—once on the left-hand top corner in figures, and a second time in words in the body itself.

4. **PARTIES.** The name of the payee is given in the body of the bill along with the word 'bearer' or 'order', that of the drawee along with his address on the left-hand bottom corner, and that of the drawer on the right-hand bottom corner where he signs it.

5. **STAMP.** All bills except those payable on demand must be stamped *ad valorem*, according to the law of the

country in which they are made.

6. **VALUE RECEIVED.** This phrase is added at the end, in the body, and signifies that the same has been drawn in consideration of value that the drawee has received.

Foreign bills are usually drawn in a set of two to three, and each has a reference to the other or others as the case may be. The drawee is liable on only one of them. Each of these copies is known a *via*. If a foreign bill is drawn singly, it is known as a *sola* bill of exchange. Sometimes, a foreign bill drawn abroad requires to be re-stamped on its arrival in the country where the payee or the drawee resides.

Every *time bill* requires to be accepted by the drawee, who does so usually by giving his signature across the bill. He may also add the word 'accepted' or the word 'accepted' along with the place of payment. So long as a bill is not accepted, it is called a draft, and when it is accepted, the same is called an acceptance. Acceptance of a bill may be general or qualified. A general acceptance is one where the drawee without adding any conditions or qualifications assents to the order of the drawer. A qualified acceptance, on the other hand, is one where the drawee does not assent to the terms of the draft but adds some conditions or qualifications at the time of acceptance. It may, then, be :—

1. **CONDITIONAL.** Where the payment is made dependent on the happening of an event therein stated; *e.g.*, payable on the arrival of the goods.

2. **PARTIAL.** When he undertakes the payment of a part only of the sum ordered to be paid.

3. **LOCAL.** Where he undertakes to pay at a specified place and not otherwise or elsewhere. It has already been observed that the mere specification of the place of payment at the time of acceptance does not constitute a qualified acceptance. It is known as such only when along with the name of the place of payment some such words as 'and there only' are added that the acceptance is known as a qualified acceptance. When place of payment is

mentioned, the bill is known as a domiciled bill.

4. QUALIFIED AS TO TIME. Where he undertakes the payment at a time other than that at which under the order it would be legally due, e.g., for 60 days after date or sight 90 days after date or sight.

5. AN ACCEPTANCE BY SOME OF THE PARTIES ONLY. Supposing a bill has been drawn on two persons, while it is accepted by only one of them.

A draft may be negotiated even before its acceptance. The holder of a bill is not bound to accept a qualified acceptance, and he may treat it as dishonoured for acceptance. In case he accepts it without the consent of the previous parties, they are relieved of all liabilities. The drawee may be allowed forty-eight hours (exclusive of holidays) to consider whether he will accept a bill.

A bill may be dishonoured for non-acceptance or non-payment. In case any instrument is dishonoured, the holder thereof must give notice of the fact to all parties whom he wants to make liable thereon.

When a promissory note or bill of exchange has been dishonoured, the holder may get such dishonour noted by a notary public upon the instrument, or upon a paper attached thereto, or partly upon each. This note must be made within a reasonable time after the dishonour and must specify the date of dishonour, the reasons if any assigned for such dishonour, or if the instrument has not been expressly dishonoured, the reason why the holder treats it as dishonoured and the amount of noting charges.

When the above note is certified by a notary public, the certificate is called a *protest*. In case of foreign bills, protest is necessary. If the acceptor of a bill of exchange has become insolvent, or his credit has been publicly impeached, before the maturity of the bill, the holder may request a notary public to demand better security of the acceptor, and on its being refused may cause such facts to be noted and certified as aforesaid. This certificate is called a protest for better security.

When a bill has been noted or protested for non-acceptance, better security, or non-payment, any person

not being a party already liable thereon may with the consent of the holder, by writing on the bill accept or pay the same for the honour of any party thereto.

When the drawer is not certain whether a bill will be accepted and if accepted, paid on its due presentation, he mentions generally on its back the name of his own agent or correspondent who will accept or pay it on his behalf in case it is dishonoured by the drawee. This party is known as 'a drawee in case of need.'

Any *material alteration* of a negotiable instrument renders it void as against any one who is a party thereto at the time of making such alteration and does not consent thereto. The following are, however, *not material* alterations :—

1. When inchoate stamped instruments are completed. Sometime one person signs and delivers to another a paper stamped in accordance with law relating to negotiable instruments then in force in that particular country, and either wholly blank or having written thereon an incomplete negotiable instrument. This is called an inchoate stamped instrument, and may be completed by the holder. The person giving it is fully liable thereon.

2. When a blank endorsement is converted into a full endorsement by writing the name of the endorsee just above the signature of the endorser.

3. When an uncrossed cheque is crossed generally or specially.

4. When the words 'not negotiable' are added to the crossing.

5. When the banker to whom a cheque is crossed specially crosses it specially again to another banker for collection.

The examples of *material* alterations are as follows :—

1. A change in date with a view to reduce or increase the period of currency.

2. A change in amount.

3. A change in the tenor.

4. A change in the number of parties liable thereto.

5. A change in the rate of interest or that of exchange.
6. A change in the place of payment.

Promissory Note. 'A promissory note is an instrument in writing (not being a bank note or a currency note) containing an unconditional undertaking signed by the maker to pay a certain sum of money only to or to the order of a certain person, or the bearer of the instrument.'

The parties to it are only two, *viz.*, (1) maker, the person who writes it, usually a debtor, and (2) payee, the person in whose favour it is made, usually a creditor.

A promissory note may be made out by one person, or by a number of persons. If made by a number of persons, the liability of the makers may be only joint or joint and several. In the case of a joint liability all the makers must be sued together on dishonour, because if any one of them is left out and the entire amount is not recovered from the rest, he cannot be sued separately to make up the deficiency. But in the case of a joint and several liability, there is no such fear. If somebody is left out, and the whole amount is not recovered from the rest, it can be recovered from him. The person paying in a joint or joint and several note can, however, get a *pro rata* contribution from the co-makers thereof.

SPECIMEN PROMISSORY NOTE

<div style="border: 1px solid black; padding: 5px; display: inline-block;">-/2/-</div>	Rs. 400	Allahabad, November 25, 1941.
One month after date I promise to pay to Mr. Jaigopal the sum of Rupees four hundred only, value received.		
Balram Das.		

SPECIMEN PROMISSORY NOTE

(Joint)

Rs. 200 <div style="border: 1px solid black; padding: 5px; display: inline-block;">-/1/-</div>	On demand, we promise to pay to Mr. Ram Anugrah the sum of Rupees two hundred only, value received.	Cawnpore, October, 15, 1941. Brajmohan Lal, Bhagwati Prasad.
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SPECIMEN PROMISSORY NOTE

(Joint and Several)

[2/

Rs. 600

Cawnpore,

August 29, 1941.

Three months after date, we jointly and severally, promise to pay Mr. Raghvendra or order the sum of Rupees six hundred only, value received.

Mahmood Khan,
Shahabuddin.

Section 25 of the Indian Paper Currency Act prohibits issue of promissory notes, private bills and hundis payable to bearer and on demand to any person in British India. Since the establishment of the Reserve Bank of India, its Issue Department can issue such notes. On this very ground *a branch bank cannot issue a bank draft payable to bearer on any other branch or head office of the same bank.*

Hundis

Though Indian Negotiable Instruments Act mentions of only cheques, bills of exchange and promissory notes, the Law Merchant or commercial usage recognises many others as negotiable instruments. Hundis are, for all intents and purposes, equivalent to bills of exchange. They are stamped, endorsed and honoured like them. Only their phraseology is different. Jokhami hundi, of course, differs essentially from a bill of exchange. There are bills of lading, dock warrants, delivery orders (all representing goods), and share warrants, debenture bonds payable to bearer (representing long term investments) which are semi-negotiable instruments, i.e., in their case, the holder gets a right to sue in his own name and recover the goods or money, but he cannot acquire on them a better title than that of the transferor.

Hundis are mainly classified into (a) Muddati (time) and (b) Darshani (sight or demand). These are, however, further subdivided into : Dhanijog (payee only), (2) Shahjog (resembling to some extent with cross cheques—bills of exchange are never crossed), (3) Dekhanhar (bearer), (4) Farmanjog (order) and (5) Jokhami (there is no equivalent of it in modern bills—it forms, in short, a combination of a

Bill of exchange, an insurance policy, a letter of hypothecation and a contract of afreightment in one).

Muddati Hundis are hundis payable after they have run their period of tenor, which varies from place to place and trade to trade—ranging generally between 11 days to 12 months. To the period of tenor are added days of grace known by the term *gilas* (in Hindustani) in order to find out the date of maturity.

Darshani Hundis (akin to sight or demand bills) are payable on presentation.

Hundis are drawn mostly with a view to facilitate remittance of money.

Dhaniyog Hundi is payable only to the payee. It cannot be endorsed. The liability of the drawee is very great here. He has to satisfy that the party presenting it is none else but the payee mentioned within the body of the hundi. In case he makes a wrong payment, he is held liable to the real owner (*Dhani*).

Shahjog Hundi is payable only to a Shah—a respectable merchant of the town where the drawee resides. A holder of such a kind of hundi cannot get its payment himself if he is not a Shah. He must present it through a Shah. In case, the drawee violates the condition, he is liable to the holder in due course for his loss.

Farmanjog Hundi came in vogue during the Moham-medan period. It is payable to the payee or his order. It cannot be transferred without endorsement (*Bechan*). The drawee, before the payment, has to examine the *Bechan* in this case in the same way as a drawee of a bill of exchange has to do in the case of an order bill of exchange. If he pays it to a wrong party he is liable to the real owner.

Dekhanhar Hundi is payable to the bearer. Here the drawee is not required to take any extra trouble. Anybody presenting it gets the payment.

Jokhami Hundi has gone out of use these days due to the emergence of specialised agencies for carrying the goods from one place to another, taking the risk of advancing

money, etc. It arose out of a sale transaction, when goods were to be sent to another town generally by river-transport. The carrier acted here as an insurer as well as financier. The seller drew the hundi on the purchaser favouring the carrier who made the payment of the same to the drawer on receipt of the goods for transport after deducting (i) his charges for carriage of the goods, (ii) premium for undertaking the risk and (iii) discount for paying the money before the hundi was paid up. The carrier in his turn got its payment from the drawee on safe delivery of the goods to him. In case he lost it he did not present the hundi.

A SPECIMEN HUNDI

Sidh Shri Cawnpore Shubhsthane Shri patri bhai Sitaram Lachhman Das jog likhi Prayag ji se Madhuri, Das Naram Das ki ram ram banchane. Apranch hundi kuni ek ap upar rupia 400 ankre char sau ke nima do sau ke dune pure dena. Yahan rakhe bhai Panna Lal Shambhunath ke Miti Chaitra badi panchmi Samvat 1999 se pure pachpan din piche dani dhanijog bina jabta bazar chalan hundi ki at thikane lagaye chaukas kar dena. Miti Chaitra badi 5, Samvat 1999.

REVERSE SIDE

Nime ke nime rupia ek sau ka chauguna pura rupia chaukas kar dijo.

Rs. 400

Shri patri bhai Sitaram Lachhman Das, Cawnpore.

The drawer of a hundi is known as *likhaiwala dhani*, the drawee as *uparwala dhani*, and the payee as *rakheywala dhani*. In the case of a jokhami hundi uparwala dhani is also known as *malwala dhani* and rakheywala dhani as *hundiwala dhani*.

Hundis are also paid for honour by means of *zikrichits* which are furnished by the parties liable thereto (drawers and endorsers) to the holders, and are addressed to some

other persons who are thereby directed to pay them in case of dishonour.

An uparwala dhami does not signify his acceptance of the hundi by signing on its face as in the case of a bill of exchange. He makes, on the other hand, a note of the same in his *naqal bahi*.

In case the original of a hundi is lost, its copies are given. The first copy is known as *paith*, the second *par-paith*, the third *darpaith* and the fourth *Panchaiti* or *Mai-jarnama*.

When a hundi is paid up, it is said to be *sakar gai*, and in case it is dishonoured, it is said to be *khadi rah gai*.

POINTS OF DIFFERENCE BETWEEN A CHEQUE AND A BILL OF EXCHANGE

Cheque

1. It must be drawn on a banker.

2. It must be payable on demand.

3. It is generally inland.

4. It is drawn in one's own currency.

5. It does not require any acceptance.

6. Its drawer is not discharged by the holder's failure to present it in due time unless the bank fails.

7. It is not honoured in case the payment is stopped by the drawer or if the banker learns of his bankruptcy, lunacy or death.

Bill of Exchange

1. It may be drawn on anybody.

2. It may be payable either on demand or some days or months after date or sight.

3. It may be inland or foreign.

4. It may be drawn in a foreign currency as well.

5. It requires an acceptance, unless it is payable on demand.

6. Its drawers and endorsers are discharged from liability if the holder thereof fails to present it to the acceptor at the due date.

7. It is paid by the acceptor or and in case of his refusal to do so by the drawer.

- | | |
|---|---|
| <p>8. It may be crossed.</p> <p>9. There is a statutory protection afforded to a banker in case of a forged endorsement on it.</p> <p>10. No notice of dishonour is required to be given.</p> <p>11. No noting and protesting are required.</p> | <p>8. It can never be crossed.</p> <p>9. No such statutory protection is afforded to a banker in the case of a domiciled bill.</p> <p>10. A notice of dishonour must be given.</p> <p>11. Noting and sometimes protesting as well are required.</p> |
|---|---|

POINTS OF DIFFERENCE BETWEEN A CHEQUE AND A PROMISSORY NOTE

Cheque

1. It is written usually by a creditor.
2. It is an order to pay.
3. There may be more than two parties to it, e.g., a drawer, a drawee and a payee.
4. It is payable only by a particular bank.
5. It is very commonly used and hence is an important medium of circulation.
6. It is always payable on demand.

Promissory Note

1. It is written by a debtor.
2. It is a promise to pay.
3. The parties can never be more than two, e.g., a drawer and a payee. There is no drawee.
4. It may be payable by several parties jointly or jointly and severally.
5. It is not so commonly used and hence is not an important medium of circulation.
6. It may be payable on demand or after the lapse of a certain period.

POINTS OF DIFFERENCE BETWEEN A BILL OF EXCHANGE AND A PROMISSORY NOTE

Bill of Exchange

1. It may have more than two parties, e.g., a drawer, a drawee and a payee.
2. It is written usually by a creditor.

Promissory Note

1. It can have only two parties, e.g., a drawer and a payee. There is no drawee.
2. It is written by a debtor.

3. It is an order to pay.
 4. It requires acceptance if otherwise than on demand.

5. It can be paid for honour.

6. Foreign bills are drawn in sets.

7. Its acceptors are only jointly responsible.

8. It must be noted and sometimes when it is foreign even protested.

9. It is sufficiently common in use.

3. It is a promise to pay.
 4. It requires no acceptance.

5. It cannot be paid for honour.

6. A promissory note is always drawn singly.

7. Its makers may be jointly as well as severally responsible.

8. It requires no noting and protesting.

9. It is not so common in use.

POINTS OF DIFFERENCE BETWEEN A BILL OF EXCHANGE AND A HUNDI

Bill of Exchange

1. It contains mere facts.

2. Its language is fixed.

3. It is always unconditional.

4. The name of the drawee is given in this case on the left hand bottom corner.

5. The name of the drawer is given in this case on the right-hand bottom corner.

6. The amount occurs in this case twice or at the most thrice

7. In this case acceptance is made across the instrument.

Hundi

1. It is in the form of a letter and contains salutations, etc.

2. Its language depends upon local usages.

3. It may be conditional as well, e.g., a Jokhami hundi.

4. The name of the drawee is given in this case once in the body itself and again on the reverse side.

5. The name of the drawer is given in this case in the body itself.

6. The amount occurs in this case at least five times and in so many different ways that there remains no chance of any alteration.

7. In this case it is denoted by a record in a separate book.

8. The copies of a foreign bill are made generally in triplicate or duplicate when it is drawn, and each one of these is sent by a different post.

9. It is used all over the world and hence is inland and foreign both.

10. It is governed by the provisions of the Indian Negotiable Instruments Act and English Bills of Exchange Act.

11. In case of dishonour it requires noting and sometimes protesting as well (foreign bills).

8. The copies of a hundi are not made unless they are required on the loss of the original or copy. There is, however, a provision for four copies, if necessary.

9. It is used only in India and hence is an instrument of simply internal use.

10. It is governed by local usages only.

11. It requires no noting or protesting. In fact, it is rarely dishonoured.

POINTS OF RESEMBLANCE BETWEEN THE TWO

(1) Both have three parties.

(2) Both are demand or time. In the case of both *ad valorem* stamps are required if they are to run a period before maturity.

(3) Both can be accepted for honour.

(4) Both can be discounted.

(5) Both can be endorsed.

(6) In the case of both some days of grace are to be added to their period known as tenor in order to find out the date of maturity.

(7) Both are orders for payment, and of a fixed sum.

3. Miscellaneous Credit Instruments

Bank Draft. A bank draft is a bill of exchange drawn either on demand or otherwise by one banker on another in favour of a third party or by one branch of a bank on another of the same bank or by the head office on a branch or *vice versa*. As already mentioned a bank draft if drawn by one branch of a bank on another of the same bank or by the head office or a branch or *vice versa* cannot be both

bearer and demand. It is usually used for remittance of money.

Specimen Form of a Bank Draft

IMPERIAL BANK OF INDIA

No..... Allahabad.....194 .
Rs.....

On demand pay to.....
.....Or order
Rupees
....., value received.

For Imperial Bank of India,

To

Imperial Bank of India,
Bombay.

Agent.

Dividend Warrants. Dividend Warrants are issued by Joint Stock Companies to their shareholders for dividends from profits and are payable usually at the Company's banker or registered office. They may take various forms. Generally they are in the form of drafts, drawn by the Company upon the bank in favour of the shareholders. Under the Act they can also be crossed and all rules as to crossing of cheques are made applicable to them. They may also be in the form of cheques, and in case they contain the words or "order," "or bearer," it has been held by various Courts of England that they may be treated as negotiable instruments. In India, dividend warrants are also sometimes issued in the form of a receipt.

Interest Warrants. When Government and joint stock companies wish to pay interest on sums borrowed from the people, interest warrants are issued. In the former case, they are drawn by the central bank of the country concerned upon its own self, and in the latter case by the joint stock companies upon their bankers. If and when these are drawn by a central bank upon its own self whatever form it may have, it cannot be treated as a cheque for the simple reason that it is drawn by one bank official upon another of the same bank.

Treasury Bills. They are issued both in England and

India. In India, again, they are issued both by the Central Governments and the Governments of the various provinces, since the inauguration of the provincial autonomy. They are a form of short-term borrowing and are usually issued for a term of 3 months. They are sold through the offices and branches of the Banking Department of the Reserve Bank except at Delhi either by tender or at an intermediate tap rate. When it is decided that tenders should be called for, a press *communiqué* stating the date on which tenders will be received, the amount and the currency of the bills offered for tender and the date on which payment for accepted tenders should be made is issued to the press for publication and is also communicated to important banks, brokers and firms. The applications for tender should state clearly the term of the bills applied for, the amount of the bills required and the rate which the tenderer is prepared to pay. The rate offered should be expressed in rupees, annas and quarter annas for each Rs. 100 nominal of the bills applied for. If tenders received are in excess of the amount offered a proportionate allotment is made when necessary, the minimum allotment being Rs. 25,000. Treasury bills are available in the following denominations only, namely, Rs. 25,000, Rs. 1 lakh, Rs. 5 lakhs, Rs. 10 lakhs and Rs. 50 lakhs. When it is decided to sell intermediate Treasury bills on tap, an announcement to that effect is ordinarily included in the usual *communiqué* giving the results of the tenders, the rate for such bills also being announced at the same time. On maturity, the Treasury bills are paid at the office or branch of the Reserve Bank from which they were issued.

Letter of Credit. A letter of credit is an open letter of request issued by one person usually a merchant or a banker, in the name of some other person or persons directing him or them to advance money or give credit, to a third person named therein, for a certain amount, and promising that he will repay the same to the person advancing or accept bills drawn upon himself for the like amount. It is called a General letter or a Circular letter when it is addressed to a number of persons or persons in general, and Special letter when it is addressed to a particular person.

Letters of credit may be of different forms, but two of these are important, viz., (1) a letter wherein one banker or merchant requests another to hold a certain sum at the disposal of a third person and (2) a letter wherein one banker requests another merchant to supply goods to a third person to a certain extent and re-imburse himself by drawing a bill upon the said banker which he promises to honour. The former is known as a *Personal Credit Letter* or a *Travellers' Facility Letter*, while the latter is known as a *Commercial Credit Letter*. In the case of a Personal credit letter, money is usually deposited with the issuer, and in that of a commercial credit letter it is promised to be paid to him before the due date of the bill.

A commercial credit letter may also be *revocable* or *irrevocable* (confirmed). In case, it is a revocable (unconfirmed) letter of credit, the banker has got the right to revoke it at any time but generally what is done is to give a notice before doing so. In case, it is an irrevocable letter of credit, once it is issued it cannot be revoked except of course with the consent of the person in whose name it has been issued.

Commercial letters of credit are needed specially by merchants importing goods from foreign countries. These are sent along with the indent. Goods are exported by foreign merchants and bills are drawn on the bankers issuing the letters. Thereafter they get them discounted with their own banks on the guarantee of the letters of credit they hold from the importers' bankers in which the latter undertake to accept and pay the said bills. Thus the exporters get payment immediately. Along with the bills are handed over the shipping documents connected with them and on receipt of these the bankers of the importers accept or pay the bills according as they are D/A or D/P.

They may also be *revolving* or say running. In this case, the amounts for which they are originally issued are automatically renewed from time to time as the bills under the credit are issued or paid, for example (1) if the amount is Rs. 1,000 and two bills of Rs. 500 each are drawn, as soon as any one of them matures and is paid, a

fresh bill or bills for or up to Rs. 500 may again be drawn, (2) if the amount for one draft is Rs. 1,000, or less and a draft for this or less than this amount is drawn, as soon as it matures and is paid, another draft for any amount but not exceeding Rs. 1,000 may again be drawn, and (3) if the amount of one draft to be issued is Rs. 1,000 or less, and a draft for this or less than this amount is drawn, the credit is automatically renewed and another draft for this or less than this amount may again be drawn.

I. O. U. An *I. O. U.* is a written acknowledgment of a debt made by one party to the other. By force of custom the letters '*I. O. U.*' have been substituted for the words '*I. Owe You*' because of their being pronounced in the same way. This does not require a stamp.

SPECIMEN *I. O. U.*

Bombay,
October 15, 1911.

Mr. B. P. Gupta,
I. O. U. Twenty Rupees (Rs. 20).
G. Ram Bansal.

Industrial Securities. Industrial Securities are the share certificates, stocks or warrants, debentures—registered or bearer issued by industrial companies. They are transferable though in the case of share certificates and stocks and registered debentures a transfer entry is required to be passed in the register of the issuing company, and for which a transfer form is required to be filled in by the transferor.

Government Securities. When Government borrows for long period, it borrows through these securities. They take the forms of Stock Certificates, Promissory Notes and Bearer Bonds and are inter-convertible with one exception, viz., that the stock certificates and promissory notes cannot be converted into bearer bonds. Interest is paid on stock certificates and bearer bonds without their presentation, but it is paid on promissory notes only on their presentation.

TEST QUESTIONS

1. What is credit? Describe its nature and forms. Mention its advantages and evils.

2. 'Credit is not a factor of production but a device to increase the efficiency of a factor of production.' Comment.
3. What do you understand by a 'negotiable instrument'? Is there any difference between negotiability and transferability? How can a negotiable instrument be made not negotiable?
4. Define a cheque and analyse its definition. What points should be borne in mind while drawing a cheque?
5. What are the different ways in which a cheque may be made safer?
6. Explain clearly the difference between a holder, a holder for value and a holder in due course.
7. What do you understand by a marked cheque? Under what circumstances this may be done?
8. Define a bill of exchange and draw its specimen. What points should be borne in mind while writing it?
9. How will you distinguish an inland bill of exchange from a foreign bill of exchange?
10. Does a bill of exchange require acceptance? What are the different ways in which an acceptance is signified? In this connection explain various kinds of acceptance.
11. What are the parties to a bill of exchange? Discuss in brief their respective liabilities.
12. Write short notes on the following in connection with a bill of exchange—(i) Noting, (2) protesting, (3) acceptance for honour, (4) material alteration.
13. What is a promissory note? Distinguish between a single promissory note, a joint and a joint and several promissory notes.
14. What do you understand by hundis? Give a brief sketch of different kinds.
15. In what ways a bill of exchange differs from a cheque, a promissory note, and a hundi, and in what way it resembles with the last named instrument?
16. Write short notes on—(i) Bank draft, (ii) Dividend warrant, (iii) Treasury bill, (iv) Government securities and (v) Industrial securities.
17. What do you understand by a letter of credit? Classify it and bring out the special features of each of these classifications. What is the need for such letters?

CHAPTER IX

RELATIONS OF A BANKER TO HIS CUSTOMER

In order to understand the relations of a *banker* to his *customer*, we should have a clear idea of them. We have already discussed a 'banker' in Chapter I. A customer 'must' have recognisable course of habit of dealing in the nature of the *regular* banking business and as the transactions peculiar to regular banking business' consist of only deposit and withdrawal, a customer must have a current account with a banker. Persons having other accounts or doing business ancillary or allied to regular banking business are not customers of the bank. The use of the word 'regular' in the above definition does not in any way suggest that some period must elapse after opening an account before one can be entitled to be called a customer. In the case *Commissioner of Taxation vs. English Scottish and Australian Bank, Ltd.*, it has been laid down that 'customer' signifies a relationship in which duration is not of the essence, and includes a person who has opened an account on the day before paying in a cheque to which he has no title.

A person may open (1) a current account, (2) a fixed deposit account, (3) a savings bank account, etc.

1. *Opening of a Current Account.* If a person wishes to open a current account with a banker, he must be introduced to him by one or more of his old customers. Usually a letter for opening an account is addressed to the banker in a prescribed form. Space is provided at the end of this letter for the signature and address of the person or persons introducing him. The customer is also required to give his specimen signature on the autograph book of the banker. This should be in the usual form, as his signature in future is always compared with it and in case of a slight difference between the two, difficulties may arise. Scores of cheques are returned daily by the bankers in this country with the remark 'Drawer's signature

differs'. He then makes his first deposit. The banker on its receipt issues a Pass Book, a Pay-in Book, and a Cheque Book.

Pass Book is the copy of the customer's account in the ledger of the banker which is occasionally sent for being made up. The customer must examine it carefully and refer the mistakes if any to the banker within a reasonable time.

Pay-in Book consists of blank printed slips called pay-in-slips. When money is deposited in a current account the actual amount is entered in the pay-in-slip. The foil is retained by the banker and the counterfoil is returned with the signature of the cashier. It may be referred to in case any dispute regarding the money paid in by the customer arises.

Cheque book consists of blank cheque forms. They are all of an uniform size, shape and design. Withdrawals can be made out of a current account, generally, by means of cheques, although written orders can also be issued. But as a protection against fraud and to maintain uniformity, banks do not encourage this practice. Cheques are supplied free of charge. An application for a new cheque book is required to be made on a printed form which is found near the end of the book.

2. *Opening of a Fixed Deposit Account.* On making a deposit in this account a customer gets a Deposit Receipt, which is not transferable. After the expiry of the fixed period for which money is deposited, the deposit receipt has to be presented by the depositor in order to withdraw the sum. In case renewal is desired, a fresh receipt is issued. No amount can be withdrawn before the due date. If the customer is in need of money he may request the banker to give him an advance on the security of the deposit. Sometimes he is allowed to withdraw such deposit before the due date provided he is prepared to forego interest for the period it has remained in the bank. Interest is allowed only for the fixed term, and if money is left after it, there is a loss of interest.

3. *Opening of a Savings Bank Account.* This account can also be opened like a current account by making an

application, and the customer's signatures are required to be made on the autograph book in this case as well. Again, he is also supplied with a pass book and sometimes pay-in book and cheque book also. When these are not supplied, ordinary forms are required to be used for both deposits and withdrawals, and the pass book must be presented at these times. Interest is allowed in this account on minimum monthly balances.

Let us now come to our main topic of the relations of a banker to his customer. They are numerous and complex but for our convenience we may divide them into three headings, *viz.*, (1) Principal, (2) Subsidiary, (3) Special.

1. PRINCIPAL RELATIONSHIP

The principal relationship between a banker and his customer is that of a *debtor* and *creditor*. Usually a customer establishes it by depositing money with the banker, and in such a case the former becomes a creditor and the latter a debtor. But, sometimes the banker may grant a loan to his customer, or allow him to overdraw his account. In that case he may become a creditor and the customer a debtor. The money deposited with a banker is not given to him on trust. It is lent to him so that he may make its use in his business. But there are cases where a banker is placed in the position of a trustee. In the case *Official Assignee of Madras vs. J. W. Irwin*, it has been laid down that in case a remittance is sent to a banker with instructions to purchase shares in a certain company and the bank buys some shares, but before completing the rest of the purchase, it fails, it stands in the position of a trustee to the remitter, and therefore, must refund the entire unspent balance to him. But this must be distinguished from another case, *viz.*, *Official Assignee of Madras vs. D. Rajaram Aiyar*, where it was held that in case a person had an account with a banker and asked the latter to buy certain securities out of the money which the former agreed to do, but failed before doing so, the agreement did not make the banker trustee for the amount in deposit. If a banker receives cheques and bills, etc., from his customer for collection, their proceeds, unless something is settled between them to the contrary, are also not to be

held in trust but to be treated as a debt.

Certain Peculiarities of the Relationship. This relationship has certain peculiarities, and the ordinary rules applicable to a loan do not apply to it. First of all, when a banker accepts a deposit from a customer, he can repay it only on his request, and not on his own initiative as is possible in the case of an ordinary borrowing. L. J. Atkin, in the course of his judgment in *Joachimson vs. Swiss Bank Corporation* observed this very clearly. He also said that it is a term of the contract that the bank will not cease to do business with the customer except upon reasonable notice. Secondly, the decision in this case also implied that the ordinary statute of limitations could not be applied to balances in the accounts which had remained dormant for more than three years in this country and six years in England. In fact, bankers had never been in the habit of taking its advantage. Thirdly, in such a case, the banker enters into an implied contract to repay the amount in the manner directed by the customer. The usual instrument employed by the customer for his directions is the cheque. If a banker pays away any amount against the directions contained therein, either through fraud, misrepresentation or an error, he is held liable for it to his customer. Exception must be made in those cases where he is protected by statute. He cannot also dishonour his customer's cheques except under certain conditions. It may be said that in all cases, the banker is liable only to his customer and not to a third party—the holder of a cheque. Fourthly and finally, a banker is bound to maintain perfect secrecy as regards the account of his customer except on 'reasonable and proper occasions.' As regards such reasonable and proper occasions, no mention has been made anywhere in the law. But it may be presumed that he may disclose it under one of the following conditions:—

(a) When he is ordered to do so by a court of law. This is possible in case the customer is a judgment-debtor of somebody else.

(b) When the customer himself directs him to do so. Such a direction may be implied or expressed.

(c) When it becomes necessary for the protection of his interests. Supposing a litigation is going on between a

banker and his customer, and the former has to disclose the state of the account in connection with it.

(d) When it becomes a public duty. This is a very vague term, and the banker must exercise his own discretion in determining whether a particular instance constitutes this.

He can, however, give out informations regarding the general position of the account in case somebody wants to be acquainted with it probably with a view to enter into business relations with him. But this must be done with special care.

Protections Afforded to a Banker by Statutes. The usual practice for a banker is to keep a specimen of his customer's signature and carefully tally it with those on cheques, etc., drawn by him before making any payment whatsoever on their basis. If the drawer's signature is forged or unauthorised, however clever the forgery, the banker cannot debit his customer's account in case he makes the payment. But there is an exception to this rule, and it is where the banker can prove that this payment made by him was due to negligence imputable to the customer. There is no statute to this end, but the position has been made clear in the course of certain important judgments. C. J. Best in *Young vs. Crote* said that the banker cannot be called on to pay, if he has paid more than what he ought to have paid because of the fault of the customer. Though this is more applicable to a case where the customer draws a cheque so negligently that a forger has the chance of altering the amount, it may hold good in the case of a forged signature also. But negligence imputable to the customer must be clearly distinguished from mere carelessness. In the case *Scholfield vs. Landasborough*, Lord Halsbury during the course of his judgment observed that if the customer by any act of his induces the banker to act upon the document, by his act or neglect of some act usual in the course of dealing between them, it is quite intelligible that he should not be permitted to set up his own act or neglect to the prejudice of the banker whom he thus misleads or by neglect permits to be misled. A customer is also under obligation to inform the banker

as soon as it comes to his knowledge that his forged signatures have been made, and any violation of this rule is sure to prejudice his interests. In *Greenwood vs. Martin Bank Ltd*, where a customer of a bank discovered that his wife had drawn forged cheques on his current account but remained silent for nine months and when she died thereafter he claimed to be credited for all these amounts on the ground that the banker had paid forged cheques, it was held that the customer's silence until after the death of the forger resulted in bank's loss of its right against the forger and, therefore, he was stopped from relying on the said forgeries. A banker is also protected against liability for payment on forged endorsements provided he takes reasonable care in meeting the cheques in good faith, without negligence, and in the ordinary course of business. In this country the position as described by Section 85 (1) of the Indian Negotiable Instruments Act is quite simple and clear. It lays down "where a cheque payable to order purports to be endorsed by or on behalf of the payee, the drawee is discharged by payment in due course". The English Bills of Exchange Act, Section 60 also lays down the same principle. It may, however, be said that the protection does not extend in the case of payment on a bill of exchange domiciled with a banker. The question whether a particular endorsement purports to be that of the person by or under whose authority it was required to be made is difficult to answer. But the bankers answer it by exercising their own common sense in the light of certain decisions of the courts and mercantile usage. We shall look to them in greater detail in connection with the method of endorsements. The terms 'in good faith,' 'without negligence' and 'in the ordinary course of business' are also important. Payment of a crossed cheque to any one not a banker is not in the ordinary course of business. Or, again, the payment of a cheque after or before the business hours is not in the ordinary course of business, and so on. For all such cases, however, we may refer to the conditions under which cheques may be dishonoured. 'In good faith' means payment without any knowledge of the defect in the title of the holder, and 'without negligence' means payment after taking proper care to the effect that the

payee is the person who should really get the payment.

Endorsements

Section 15 of the Indian Negotiable Instruments Act defines endorsement as follows: "When the maker or holder of a negotiable instrument signs the same otherwise than as such maker, for the purpose of negotiation on the back or face thereof, or on a slip of paper annexed thereto, or so signs for the same purpose a stamped paper intended to be completed as a negotiable instrument, he is said to endorse it and is called the endorser." Here the phrase 'for the purpose of negotiation' is important, and further it may be said that this implies the delivery of instrument by the endorser to the endorsee. Section 31 of the English Bills of Exchange Act clearly lays down that "an endorsement means an endorsement completed by delivery." A partial endorsement is of course not allowed, it should be always for the entire amount. In case endorsement is made on a separate piece of paper and this is usually done when there is no space on the back of the instrument so as to allow further endorsements to be made on it, the separate piece of paper is known as an *allonge*, and must be fastened to the instrument. Usually first endorsement on an allonge is made in such a way as to be written both on an instrument and the allonge.

Kinds of Endorsements. The endorsements may be any of the following :—

1. **BLANK (GENERAL OR SIMPLE).** In this case there is only the signature of the endorser.
2. **SPECIAL (QUALIFIED OR FULL).** In this case there is also the name of the endorsee.
3. **PARTIAL.** It means transference of only a part of the total amount. This is, however, not legal.
4. **RESTRICTIVE.** (a) Where it prohibits further negotiation but not transference, *e.g.*, pay to Shyam only, (b) where it restricts the endorsee to deal with the proceeds only as directed, *e.g.*, pay to Shyam for my use. The banker is not bound in this case to assure himself that the proceeds will be used for the purpose required. It has the effect of binding only the endorsee.

5. **SANS RECOURSE.** Where the endorser makes it clear that the endorsee, and subsequent parties to him should not look to him for payment in case the instrument is not paid by the drawee, *e.g.*, *Sans Recourse* Jai Raj Behari.

6. **CONDITIONAL.** Where the payment is to be made on the fulfilment or non-fulfilment of a condition, *e.g.*, pay to Ram Lal on marrying Kalawati. But this condition may be disregarded by the banker.

7. **FACULTATIVE.** When an instrument of credit is dishonoured by the drawee, it is the duty of its holder to give a notice of the dishonour to the drawer and all the parties previous to him liable thereto. But in the case of a facultative endorsement, the endorser waives the right of receiving this notice, and agrees to be held liable to make the payment in spite of the fact. The usual words preceding the signature in the case of such an endorsement are: "The right of receiving notice of dishonour waived."

Method of Endorsements. If endorsements are made in a particular method which suggests their having been made by or on behalf of the payee, there is a saving of a good deal of inconvenience. It also affords a protection to the paying banker under the statute which has already been referred to.

In the case of a cheque payable to an individual, there should not arise any difficulty in making the endorsement. First of all, it should be borne in mind that this must be in the same spelling as the payee's name on the cheques. Thus in case the correctly spelt name of, say, Ram Dular the payee, has been mis-spelt in the cheque as Ram Dulare, it is to be spelt in the endorsement too as Ram Dulare and not as Ram Dular. However, the payee, if he so desires, can give his correct spelling within brackets below the signature in the spellings already appearing in the cheque. Secondly, if the payee's name on a cheque has been written in full, the signature in the endorsement must also be made in full. An exception may, however, be made in the case of a Christian name. Thus a cheque in favour of Ram Lal Agrawal should be endorsed as Ram Lal Agrawal, and not as R. L. Agrawal. But a cheque in favour of James Smith

may be endorsed, as J. Smith. A cheque in favour of R. L. Agrawal may, however, be endorsed as R. L. Agrawal. Thirdly, courtesy titles should always be omitted from all endorsements whether they be of individuals or of joint persons, *e.g.*, Ram Lal and not Ram Lal, Esqr., or Mr. Ram Lal, etc., and Ram Lal Shyam Lal not Messrs. Ram Lal Shyam Lal or Syt. Ram Lal and Shyam Lal. The reason for this is that usually a person does not add courtesy titles to his name, while he himself writes it. Hence, in case courtesy titles are added to the names in the endorsements, they do not purport to have been made by the endorsers themselves, and what is of importance to a banker is not whether they have been really made by them but whether they purport to have been made by them. But in case they are made on behalf of somebody else, courtesy titles may be added to the names of those persons on whose behalf they are made, *e.g.*

For Mr. Shyam Lal,

Ram Lal,

Personal Secretary.

For Messrs. Ram Lal Shyam Lal,

J. Biswas,

Manager.

In certain countries, such as France and Germany, courtesy titles are added to the signature and hence in such places, the banker may regard them as regular. What has been said above is only with regard to courtesy titles and not professional, academical and distinction titles. Thus Ram Babu, Ph.D.; Kaushal Kishore, Rai Bahadur; Tej Bahadur Sapru, Kt, C.I.E, cannot be written as Dr. Ram Babu, Rai Bahadur Kaushal Kishore, Sir Tej Bahadur Sapru respectively. Unmarried women can add 'Miss' and married women 'Mrs.' within brackets after their signatures to denote whether they are unmarried or married. Thus Shanti Devi (Miss), Kamini Bai (Mrs.) will be correct and not Miss Shanti Devi and Mrs. Kamini Bai. Finally, if an endorsement is made on the authority of somebody, such authority must be named. In case, it has been bestowed through a law court, the words per procuratorem or their abbreviations, *e.g.*, Per Pro., p. p. must be placed before the payee's name. Otherwise the situation or office must be mentioned

immediately after the signature. As for example :

P. P. Ram Lal,
Shyam Lal.

For Ram Lal,
Shyam Lal,
Secretary.

The following are also regular :

Ram Lal,
By his attorney
Shyam Lal.

Ram Lal,
Shyam Lal,
Secretary.

When the payee is an illiterate person, his thumb impression or mark must be properly witnessed. As far as possible the witness must be the banker's previous acquaintance. Generally his full address is desired by the banker. The endorsement in this case will appear as follows :—

<i>Name</i>	<i>Thumb Impression</i>	<i>Witness</i>
Jeewan Jyoti	(Impression)	Sheo Kumar Singh, 15, Zero Road, Allahabad.

In the case of a cheque payable to more than one individual, the endorsement must be made by all. If they constitute a partnership firm, any of the partners may write the name of the same, *e.g.*, for a cheque payable to Messrs. Ram Lal Shyam Lal (a partnership firm), any of the partners may write Ram Lal Shyam Lal. But usually, a banker also requires the mention of the name of the partner making the endorsement, *e.g.*,

For Ram Lal Shyam Lal Ram Lal Shyam Lal,
Ram Lal. Ram Lal.

In case the endorsement is made by somebody other than a partner, he must mention the authority also.

If a cheque is made payable to "Messrs. James," it may be endorsed as "James and Son," or "James and Sons," or "James and Brother," or "James and Bros." "James and Co." will however, be irregular as "Messrs. James" signifies a large number of James. But it is not good to draw cheques in this form.

In the case of a joint stock company or any other

institution, the regular form of endorsement
 For Northern India Trading Co., P. P. Northern
 Co.,

J. Biswas,
 Manager.

J. Biswas

For C. A.-V. High School,
 Beni Prasad,
 Headmaster.

C. A.-V. High School
 Baldeo Prasad,
 Manager.

The following will, however, be irregular as they are personal endorsements.

J. Biswas,
 Manager,

Beni Prasad,
 Headmaster,

Northern India Trading Co.,
 Baldeo Prasad,
 Manager,

C. A.-V. High School.

C. A.-V. High School

It is a well-known legal principle that an agent cannot delegate the authority conferred on him by his principal, and hence any endorsement made for an agent is irregular.

A cheque payable to trustees must be signed by all the trustees. Bankers refuse to accept a *per pro* endorsement or an endorsement of a single trustee on behalf of his co-trustees. "This rule is very necessary owing to the strictness with which the courts always safeguard the interests of the beneficiaries of a trust. The knowledge that the trust funds are being dealt with, imposes on all those to whom such knowledge can be imputed the necessity of more than ordinary precautions for the prevention of fraud."² The endorsement must indicate the name of the trust also.

In the case of executors and administrators, however, an endorsement by a single executor or administrator on behalf of the body of executors or administrators is regular, *e. g.*

For self and co-executors of Mr. Shyam Lal
 J. Gangola

²Please consult Sykes, *Banking and Currency*, page 143.

A cheque payable to a married woman in her husband's name, e.g., Mrs. J. Biswas, should be endorsed as Rama Bai, wife of Mr. J. Biswas. A cheque payable to a Christian Miss say Miss Elizabeth Jones, will be endorsed after her marriage with James Smith as Elizabeth James *nee* Jones.

There are some more points regarding the methods of endorsements which may also be taken up here. Though an endorsement in pencil or made by a stamp is valid, it is not accepted by a banker. Where the payee or endorsee presents a cheque in person, it is usual for the banker to insist on having his signature on its back. This is not an endorsement, as it is not made for the purpose of negotiation, while we have seen already in the definition of an endorsement that it is an essential part of it. This is a receipt for the money which the banker pays. If the payee or endorsee, whoever the person presenting the cheque be, refuses to sign as such, the banker can demand a receipt and this if for an amount of Rs. 20 or more in India, and of £2 or more in the United Kingdom must bear a revenue stamp. Penalty for refusing to give a receipt is very heavy and so it should not be refused. It may, therefore, be said that there is no gain by refusing to put the required signature, and as there is no liability in doing so, it must be put without any grumbling or anything like that. If a cheque is payable to a fictitious or non-existent person or to wages, rent, etc., it must be treated as payable to bearer. If a cheque is originally drawn payable to bearer, it remains a bearer cheque both under the English Bills of Exchange Act and the Amending Indian Negotiable Instruments Act (1931), notwithstanding endorsement in full or blank.

Conditions under which Cheques may be Dishonoured

It was said in connection with the peculiarities of the relationship of a debtor and creditor between a banker and his customer that the former cannot dishonour the latter's cheques, except under certain conditions. Herein we must look up to these :

(1) A banker dishonours his customer's cheques for want of regular endorsements.

(2) He does so if the signature of the drawer on it does not conform with the specimen signature with him.

(3) If the cheque is a post-dated one, *i.e.*, if it bears date which is as yet to arrive as he is not allowed to debit his customer so long as the date which it bears does not arrive, and hence, in case the customer becomes bankrupt or lunatic, or dies in the meantime, he loses the amount if already paid. If a post-dated cheque has been paid, and due to this payment, there is no sufficient balance left to enable the banker to pay a regular cheque, he cannot dishonour it. The regular cheque must be honoured, if there would have been sufficient balance to enable the banker to honour it had the post-dated cheque been not paid. The customer has also got the right to stop the payment of a cheque before its due date. In case he does so the banker stands to lose if he has already paid it.

(4) If it is a crossed cheque and not presented through a banker. It must be remembered that a crossed cheque cannot be paid on the counter of a bank.

(5) If it is a stale cheque, *i.e.*, if the date on it is of a day six months previous to the date of presentation. There cannot be any objection in the payment of any other antedated cheque, *i.e.*, one bearing a date previous to that of the presentment but not more than six months.

(6) With regard to the trust funds, if he has got the least doubt regarding the use of the amount proposed to be withdrawn so long as it is not removed. It has already been observed that a banker has to be extra-cautious in his dealings in the trust funds.

(7) If there is any doubt regarding the amount. It must be the same both in words and figures. A banker may make the payment according to what has been given in words, though the better course is always to refer it to the drawer. All alterations, specially those in connection with the amount must be initialled by the drawer.

(8) If there is no balance left in the customer's account to enable the payment of a cheque to be made. If an arrangement for an overdraft has already been made the

cheque must be honoured. Such an arrangement cannot be cancelled without giving an adequate notice. If a banker has made a mistake in striking out the balance of a customer's account in the pass book, and the customer acting on the basis of such a balance has drawn a cheque, the banker must honour it. He has, however, got the right to claim the amount from his customer.

(9) If the drawer himself has stopped the payment. A banker has to obey all commands of his customers regarding his account.

(10) If the customer is declared to be bankrupt, or lunatic, or if he dies.

(11) If an appropriate court of law serves a garnishee order. If *A* has obtained a judgment against *B* in a court of law, such judgment may be satisfied by levying execution against *B*'s property, or by appointing a receiver, or by obtaining the service of a garnishee order on any person known to have funds of the judgment-debtor in his hands. If, then, *A* knows that *B* has an account with a banker, he may get a garnishee order served on him; the garnishee order being a warning issued by the court of *A*'s charge on *B*'s account and forbidding the banker to hand over such fund, or to deal with it in any way to the detriment of *A*. Even if the balance to the credit of *B*'s account is Rs. 1,000, and the amount of the debt is only Rs. 100, the banker has to dishonour all cheques, since the order charges the whole account.

Reasons generally assigned by the bankers for dishonouring their customers' cheques

The following are usually the reasons assigned by a banker for dishonouring a cheque :

1. REFER TO DRAWER (R/D). This is a very vague term. It means that there is something wrong with the cheque. It is usually put down in case there is no sufficient 'fund to the balance of the drawer's account'.

2. NOT ARRANGED. This means that the customer's particular account on which the cheque has been drawn, has not got sufficient balance to enable the banker to make the payment, though there is a balance in other accounts and

payment could be made, had a transfer been arranged for by the drawer. The banker has, however, got the right to make the payment by transferring the necessary amount from the account having a surplus balance.

3. EFFECTS NOT YET CLEARED, PLEASE PRESENT AGAIN. It sometimes happens that a cheque is presented for payment just at the time when the drawer has paid into his credit certain cheques which have not been cleared. Under such circumstances the cheque is returned with the above remark.

4. EXCEEDS ARRANGEMENT. This again shows shortage of funds. It may be possible that the amount of the cheques is more than the amount of the overdraft available or the amount of the transfer from other accounts is available.

5. INSUFFICIENT FUNDS. This clearly shows that the funds are not sufficient to enable the payment of the cheque. This remark should be avoided as far as possible. Reason number (1) may be assigned to indicate it.

6. FULL COVERS NOT RECEIVED. This is another remark meaning the same as (5).

7. PAYMENT STOPPED BY THE DRAWER. This term is self-explanatory.

8. DRAWER'S SIGNATURE DIFFERS. The banker keeps an autograph book in which it has the specimen signature of all the customers. When a cheque is presented to the bank, the signature on it is confirmed with the specimen signature in the autograph book. The term indicates that the two signatures differ.

9.PAYEES' ENDORSEMENT IS INCOMPLETE OR REQUIRED/IRREGULAR/ILLEGIBLE. In the blank space is filled 1st, 2nd, 3rd, etc., as the case may be. This indicates that the endorsement of the particular payee is incomplete, or required, or irregular, or illegible. 'Complete endorsement means signature along with all the suffixes as given in the body of the cheque or in subsequent endorsements. 'Irregular' means not according to the regular practice.

10. ENDORSEMENT REQUIRES BANK'S GUARANTEE OR CONFIRMATION. In case a cheque is presented through

a bank, and there is any doubt with regard to a particular endorsement, it may be referred back to the collecting bank for guarantee or confirmation. In case of its turning out to be forged later on, the collecting banker is held liable.

11. **DRAWER'S SIGNATURE REQUIRED** This remark may be put in case the drawer has missed to sign.

12. **CHEQUE IS MUTILATED/POST-DATED/OUT OF DATE.** A mutilated cheque is not paid. In case it has been accidentally torn, the drawer must certify the fact on the face of the cheque itself. Similarly, a post-dated cheque is not paid so long as the date given on the cheque does not arrive. A cheque more than 6 months old becomes out of date and is not honoured with the consent of the drawer.

13. **AMOUNT IN WORDS AND FIGURES DIFFER.** The banker may pay the amount in words, but he can also return the cheque in this case with the above remark.

14. **CROSSED CHEQUE MUST BE PRESENTED THROUGH A BANK.** A crossed cheque cannot be paid to anybody else except a bank.

15. **CLEARING STAMP REQUIRED.** The clearing bank ought to put its stamp. In cases it does not do so, the cheque may be returned.

16. **ALTERATION REQUIRES DRAWER'S CONFIRMATION.** Even a slight alteration must be initialled by the drawer. If it has not been done so, the cheque must be returned.

17. **DRAWER DECEASED** A banker cannot pay a cheque on receiving the information of his customer's death.

18. **DRAWER DECLARED BANKRUPT.** This remark should be made only after having made full confirmation of the fact.

19. **GARNISHEE ORDER SERVED.** In case a court of law has done this, the cheque cannot be honoured.

20. **TYPE-WRITTEN CHEQUE.** A typed cheque is not paid by the banks.

Banker's liability on wrongfully dishonouring a cheque

A banker cannot dishonour a cheque without any sufficient reason. In case, he dishonours it wrongfully, he is not only liable to make good the loss caused to the

customer by such a dishonour but is also required to give a reasonable sum for the loss of his reputation. When a person's cheque is dishonoured, and specially for want of funds, it brings a bad name to him, and in business this is always to be avoided. As to the amount which will be regarded as a reasonable sum to be given by a banker to his customer for the loss of his reputation by wrongfully dishonouring his cheque, it will be decided by a court of law which take into consideration various things. It will see whether it is customary or not for the people of the particular locality to regard the dishonour of a cheque as disreputation for the drawer. It will also see, if a particular customer's cheques have ever been dishonoured or not due to the fault of the customer. If this is so, it will not regard the dishonour as a loss of reputation, but only a matter of ordinary routine.

Payment of domiciled bills

A domiciled bill is one whose payment is to be made at the drawer's bank. It is customary for the people to put down the name of the bank where a bill is payable at the time of putting down the acceptance. A banker has ordinarily no obligation to honour a domiciled bill unless and until it is expressed or implied in any way. In case he has been honouring such bills for sometime, the obligation is implied and they must be honoured so long as sufficient notice cancelling the obligation is not given by him. A banker can dishonour such a bill even in the following cases—

(1) When it is not in proper form.

(2) When it is not duly stamped. Every time bill require to be stamped according to the law of the country. In India, the Central Government has reduced by a notification dated the 13th January, 1940, the duty chargeable on revenue bill of exchange made or drawn in and payable in India and having a usance not exceeding one year to two annas for every one thousand rupees or part thereof.

(3) When it is presented before the date of maturity.

(4) When there are any material alterations on it and they have not been confirmed by the drawer.

(5) When the acceptors' signatures are forged. These, he must compare with the specimen in the autograph book.

(6) If the signature of the payee or that of any subsequent endorsee is forged. A banker has not been given protection against payment of domiciled bills bearing forged endorsements as has been given against that of cheques. This is really a very great drawback, as it is not possible for a banker to recognise the signatures of each and everybody. Usually a banker secures his position by taking a guarantee from the last holder to the effect that the latter would indemnify him in case any of the endorsements on the bill turns out to have been forged.

(7) When the acceptor has been declared bankrupt. In the case of death also, it should be referred to his successor.

2. SUBSIDIARY RELATIONSHIPS

They are two in number : (1) that of an agency : and (2) that of a trust.

1. Agency Relationship

In all cases, when a banker makes payment on the order of his customer, whether it be in the form of a cheque or a bill domiciled to him, he acts as an agent, and as such is responsible to his principal, the customer for all the acts done by him. Any breach either through error or negligence renders him liable in the same way as it renders an agent to his principal. But he has been given a special protection against payment on forged endorsements and this we have already gone through.

We know that a banker also collects his customer's cheques, bills, promissory notes, coupons, dividend warrants, subscriptions, rents, income-tax, insurance premia, and other periodical receipts. He purchases and sells on his behalf shares, stocks, debentures and bonds, etc. In all these cases and in sundry others, his relationship with his customer is again that of an agent and principal, and as such all the rights and obligations between them are governed by rules relating to agency. There is, however, one exception and it is in connection with the collection of a crossed cheque.

General Crossing A cheque is said to be crossed generally in case it has only two transverse parallel lines with or without some such words as "& Co.", "Not Negotiable," "Account payee only", "under one hundred rupees" singly or in combination, but without the name of a bank within it. The following are the Specimen of General Crossings :—

1	
2	& Co.
3	Not Negotiable.
4	Not Negotiable & Co.
5	Under one Hundred Rupees, & Co.
6	& Co. Account Payee Only.
7	Not Negotiable. Account Payee Only.
8	Account Payee Only.

Special Crossing. A cheque is said to be specially crossed, if in addition to the words given above or without them there is also the name of some bank within the two transverse parallel lines contained therein. For specimen of it, we may have any of the forms given under general crossings but with the name of a bank and without the words "& Co." The effect of this kind of crossing is, that it can be paid only through the particular bank whose name is mentioned within the crossing. A cheque cannot be crossed specially to more than one banker excepting in-

the case when it is crossed to an agent for the purpose of collection, and in case of the violation of this rule, the banker on whom it is drawn shall refuse payment thereof.

Protection afforded to a banker in connection with the collection of a crossed cheque for his customer. When a banker collects a credit instrument for his customer, he does it in the capacity of an agent and hence his title to the instrument depends upon that of the principal, *i.e.*, the customer on whose behalf he collects it. From this it is obvious that in case the customer's title to it proves defective, he incurs a liability to its true owner, and may be required to make good his loss. But, Section 131 of the Indian Negotiable Instruments Act, and Section 82 of the English Bills of Exchange Act afford protection to a banker provided he collects a crossed cheque for his customer. Section 131 of the Indian Negotiable Instruments Act lays down as follows: "A banker who has in good faith and without negligence received payment for a customer of a cheque crossed generally or specially to himself shall not, in case the title to the cheque proves defective incur any liability to the true owner of the cheque by reason of only having received such payment."

As an explanation to it, the following has also been added:—

"A banker receives payment of a crossed cheque for a customer within the meaning of this section notwithstanding that he credits his customer's account with the amount of the cheque before receiving payment thereof."

It must be remembered, that a banker is afforded this protection, only if he collects a crossed cheque and that too for his customer; in the case of the collection of an open cheque or any other instrument and for a person who is not a customer of the banker, this protection is not afforded. He is also required to act in good faith and without negligence. When a cheque is presented to a banker with a view to open a current account, he should be very careful to obtain a satisfactory reference of the person in whose name the account is required to be opened. Failure to obtain reference

and that too a satisfactory one has been held to be negligence sufficient to deprive the banker of the aforesaid protection. In *Ladbroke vs. Todd* where a thief had stolen a cheque and forged the endorsement of the payee, opened an account with it with a banker, got it collected and withdrew the proceeds, the bank was held guilty of negligence and had to refund the money. In *The Guardians of St. John vs. Barclays*, where the thief actually gave a reference of one Mr. Woolfe, at Fitzroy Square whom the bank did not know, and who in fact did not exist, the bank was held guilty of negligence.

Collecting Banker's Position as a Holder in due Course. Cheques, bills of exchange and promissory notes are negotiable instruments, the chief characteristic of which is that they can pass title by endorsements, or by mere delivery, and the transferee if he receives them *bona fide*, for value, in proper form and before the date of maturity, acquires a good title to them, no matter even if he received them from a person whose title to them was defective, and he can sue upon them in his own name. If a collecting banker relies on his position as such, *i.e.*, a *bona fide* holder for value or holder in due course, having given his customer value previous to collection, he can do so. But in case he has not given the value, or cheque in question is crossed and there exist the words 'not negotiable' within the crossing, his claim is defeated by the existence of a forged or unauthorised endorsement of any previous party. Hence, the statutes mentioned previously are of utmost importance to the collecting banker for protection against the collection of a cheque bearing a forged or unauthorised endorsement.

Suresh Kumar
121

2. Trust Relationship

A banker stands in the relationship of a trustee also to his customer. An example of it was given in the very beginning of this chapter in the case of *Official Assignee of Madras vs. J. W. Irwin*. We also know that he receives his customer's valuables, ornaments and jewels, documents and deeds, etc. for safe custody. When he receives these without making any charge for the service, he stands in the position of a gratuitous bailee, and incurs liability only

for loss caused through gross negligence. But in case he makes a charge for it he stands in the position of a paid bailee and would be liable for ordinary negligence also. This is in accordance with the English law. Indian law does not make any distinction. According to it a bailee has to take as much care of the goods bailed to him as a man of ordinary prudence would, under similar circumstances, take of his own goods of the same bulk, quality and value as the goods bailed, and in case this has been done, he is, in the absence of any special contract not responsible for the loss, destruction or deterioration of the thing bailed. But this protection does not extend to a wrongful delivery. Usually, a banker requires articles for safe custody to be delivered in a sealed packet or box, and what he has to do is to return it with all the seals intact to the depositor or his order. It has been held in several cases that a wrong delivery of it to an unauthorised person is nothing less than a conversion, *i.e.*, putting the goods bailed to one's own use, and is as such punishable under that law. But sometimes, certain instruments of credit are handed over to a banker not only for safe custody but also for the purpose of collecting interest, dividend, or the instruments themselves when they fall due. In these cases, he can also exercise the right of his general lien on them for any debt due to him by his customer. A banker's general lien must be distinguished from a particular lien.

General vs. Particular Lien. A particular lien is a right to retain an article until all charges in connection with it have been satisfied. A general lien, on the other hand, is a right to retain valuables until all debts due by the owner to the holder have been discharged. Bankers have both a particular lien and a general lien. But it may be said here that in cases a banker has a particular lien on a certain article he cannot also claim a general lien on it. To take an illustration, supposing that securities of the value of Rs. 10,000 have been deposited with a banker to secure a debt of Rs. 8,000. Here, the banker gets a particular lien on these securities to the extent of Rs. 8,000 plus interest. In case the customer fails to pay this amount the banker can recover it out of these securities, but he cannot claim a general lien on the balance left if any for some other debt.

which the customer owes him. If the securities are left with the banker even after the payment of the particular loan, he acquires a general lien on them as well. A lien does not in any way give the power to sell the securities concerned. They can be utilised as such only after obtaining a decree for the debt and then attaching them on execution. The bankers get a general lien on cheques, etc., given to them for collection, and then proceeds can be utilised for settling any debt due upon the customer. But in case any money is required to be utilised by the banker for a specific purpose, it must be utilised as such.

3. SPECIAL RELATIONSHIPS

The above are the general relationships between a banker and his customer. But there are certain special relationships between them, and out of these arise special liabilities of the former in dealings with the latter. First of all, as we know, a banker must not pay the cheques of a customer who has been declared bankrupt. In case he does so he is answerable to the Official Assignee in whom all the property of such a person vests for the benefit of his creditors. He should also not open or carry on an account with an undischarged bankrupt or he may possibly be called upon to refund all payments made by him on the account. We have also seen that on a notice of the death of a customer, the banker should stop payment of his cheques. What happens in such a case is that either the executor, or the deceased produces either a probate or a letter of administration or a succession certificate respectively obtained from a competent authority, and on the basis of it, the banker makes the payment to the right person. It was observed previously that a banker should not also make payment of a lunatic customer. But this must be done only after obtaining sufficient proof of the fact. Of course, if the customer is confined in a lunatic asylum, or is judicially declared a lunatic, the banker is safe in stopping the dealings. The position of an intoxicated person is also akin to lunacy, and hence care should be taken while making payment to such a person when he calls himself in for encashing his cheques. This may

be done by obtaining a reliable witness. It is safer for a bank not to have any dealings with persons addicted to intoxication.

A banker must also take care in dealings with a minor customer. It has in some quarters been argued that a minor, being unable to give a valid discharge for a debt, can, when he comes of age, repudiate, as against his banker, cheques drawn by himself upon the latter, but the better opinion seems to be against such a strained interpretation of the protection afforded by law to minors. The general practice is to open an account with a minor but not to allow him an overdraft. A minor can make endorsements and also act on behalf of others.

He should also exercise sufficient care in dealings with trustees. It has already been observed that the courts always safeguard the interests of the beneficiaries with a considerable strictness, and the knowledge that the trust funds are being dealt with, imposes on all those to whom such knowledge can be imputed the necessity of more than ordinary precautions for the prevention of fraud. Under ordinary law, the delegation of power by trustees to one of their number is not permissible. It can only be done under a clause in the deed. Thus, whether to accept the signature of one trustee on behalf of others or not must be ascertained by the banker by a reference to it. If a particular customer has an account in his personal name and another in the name of a trust, any transference by him from the latter to the former should put the banker on inquiry. Even a slight suspicion of a breach of trust requires the banker to be on guard. No misappropriation of such a fund is to be allowed in any way.

A banker is also required to act with care in his dealings with employees and agents. They have a limited authority, and hence when they do anything, it must be ascertained whether they can do it or not. Section 27 of the Indian Negotiable Instruments Act lays down, "A general authority to transact business and to receive and discharge debts does not confer upon an agent the power of accepting or endorsing bills of exchange so as to bind his principal". The word 'agent' here includes an employee. When they have

also their personal accounts along with those of their principals, the banker has to exercise vigilance lest the cheques payable to the principals might not be paid to the personal accounts. A collecting banker must be very careful, as the protection afforded to him under Section 131 of the Indian Negotiable Instruments Act can be of no avail if he acts even a little negligently. In the case *Bissel vs. Fox*,³ England, a commercial traveller opened an account with a bank in his own name and paid in to his credit cheques payable to his principal which he had endorsed "per procuration". A "per procuration" signature 'operates as notice that the agent has but a limited authority to sign,' and it was held that the circumstances were sufficient to put the banker upon inquiry as to the validity of his customer's power to endorse in this way, and that, therefore, the bank did not act "without negligence". In fact when per procurationem signatures are made, the banker must demand the Power of Attorney for his perusal.

Finally, in dealings with an undivided joint Hindu family firm, the banker must see that the cheques are signed by the managing member, known as *karta* and generally the eldest male member of the family, as he alone has the capacity in law to enter into contracts, etc., on behalf of the joint family firm. This is quite different from what is the case with a partnership firm, where every partner unless there is an agreement to the contrary has an equal right.

TEST QUESTIONS

1. Define a customer and explain the various important features in that connection.
2. What different accounts can be opened in a bank? Explain the process of opening each one of them.
3. What are the different forms of relationship that arise between a banker and his customer? Discuss the various characteristic features of the principal relationship between them.
4. What protections have been given to a banker in connection with forgery on a cheque? Discuss his position in respect

³Sykes : *Banking and Currency*, p. 131.

of (a) payment of a cheque bearing a forged signature, and (b) payment of a cheque bearing a forged endorsement.

5. What is meant by endorsing a cheque? When and how should cheques be endorsed? State different kinds of endorsements.

6. In what circumstances will a bank refuse to pay a cheque drawn upon it by a customer?

7. What are the reasons which are usually assigned by a banker while dishonouring a cheque? Explain them clearly.

8. What is the liability of a banker for wrongfully dishonouring a cheque? Illustrate your answer by suitable examples.

9. What is the liability of a banker in respect of the payment of a domiciled bill? Under what circumstances, it may be dishonoured by a banker?

10. What are the obligations and rights of a collecting banker with regard to a crossed cheque? Mention in this connection the statutory protection afforded to him.

11. What do you understand by crossing? Give various forms of it. What are its objects?

12. What do you understand by a banker's lien? Point out the difference between a general and a special lien in this connection.

13. What are the special kinds of customers with which a banker has to deal? Mention in this connection the special vigilance necessary to be exercised by him.

CHAPTER X

BANKER'S SECURITY FOR ADVANCES

We have already seen that a banker advances only on the basis of good securities. They are of multifarious types, and in order to understand the risk attached to them, we must be fully acquainted with the essential characteristics of each. A banker must be very careful while dealing with the securities. He is required not only to select those which are more or less steady in value and can be easily sold in the market but also to see that the summaries and other titles he gets on them are not unsafe.

CLEAN ADVANCES

In many cases when the customer is a man of unimpeachable reputation and sound financial position he is granted a loan or allowed an overdraft on personal security. In such a case, the banker depends entirely on his integrity, strength of character, prompt and businesslike dealings. But in order to safeguard his position, the banker may also take the signatures of one or two independent sureties or guarantors on the promissory notes executed by such a person. In case of default the principal debtor is, however, the person to whom the loan is granted. The banker can realise his claims from the surety or the guarantor only in case they remain unpaid from the property of the debtor. Such advances are known as *clean advances*.

The guarantee or surety may be *continuing* or *specific*. In case of the continuing guarantee, the surety or guarantor is held responsible for the fluctuating balance of account until the whole of the advance is repaid, while in case of the specific guarantee, he is held responsible for a single transaction only. Suppose A obtains a loan of Rs. 500. after some time he pays in Rs. 200. But he draws Rs. 100 again. The balance of Rs. 400 is thus due from him. In the case of a continuing guarantee, the guarantor is held liable for Rs. 400 and he cannot take advantage of the credit of Rs. 200 which A had paid in. In the case of a specific guarantee, however, the guarantor is held responsible for Rs. 300 only because A had once paid in Rs. 200. In this

case, he has to do nothing with Rs. 100 which A had again withdrawn without his standing as a guarantor. When a guarantor or surety has paid the money due from the principal debtor, he gets, of course, the right to claim this amount from him.

COLLATERAL SECURITIES

Borrowers are generally required to deposit collaterals for the loans advanced to them. Collaterals signify some tangible property or right of ownership to it or documents of value. 'Collateral' means 'additional' and such securities are known by this name because they stand by the side of the personal security of the borrower. In fact, they can be disposed off only in the event of his failure to repay the loans promptly. A collateral security may take either the form of a lien or a pledge or a mortgage.

A *lien* implies the right to retain the security, and not to sell it. This can be done only when a decree has been obtained from a court of law and it has been attached on execution. But in the case of fully negotiable securities, *g.*, bearer bonds, share warrants, stocks and certificates, bearer and registered debentures, bills of exchange, promissory notes and cheques, a banker's lien implies also the right to sell them after giving due notice to the customer for satisfaction of claims. It does not extend to title deeds or documents of title to goods. They can only be retained.

In the case of a *pledge*, the banker has got the right to retain as well as to sell the securities after giving due notice to the borrower. This, then, is the difference between it and a lien, with the exception of those securities which have been mentioned in the last para. Hence, a pledge is preferable to a lien in ordinary cases.

A *mortgage* is necessary when the securities offered consist of immovable property. In this case as opposed to in the case of a lien and a pledge, the possession is not transferred to the lender. It remains with the borrower or somebody appointed by him. What is usually transferred is the ownership. In the case of a lien and a pledge, however, there is usually a transfer of possession and not

of ownership. But what has been said here regarding a mortgage is true of only a legal mortgage. In fact, mortgages are of several types, though we are concerned here with only a legal mortgage and an equitable mortgage. A legal mortgage is effected by means of a mortgage-deed which is written on a stamped Government paper and is registered with the Registrar of the Mortgages. An equitable mortgage is effected, on the other hand, only by depositing the title-deeds with or without a memorandum or by depositing only a memorandum of charge and not the title-deed with the mortgagee. The difference between the two is that while in the former case the ownership of the property mortgaged passes to the mortgagee, and hence he acquires the right to sell it on default by the mortgagor, in the latter case, he has to approach a court of law for obtaining a previous sanction or order to that effect. Equitable mortgage is allowed in India only in Calcutta, Madras, Bombay, Karachi and any other town which the Governor-General by notification may specify. In the case of a legal mortgage also on repayment of the loan, the mortgagor gets back the full ownership of property. This right of the mortgagor to reclaim full ownership is called his 'equity of redemption.'

TYPES OF COLLATERAL SECURITIES

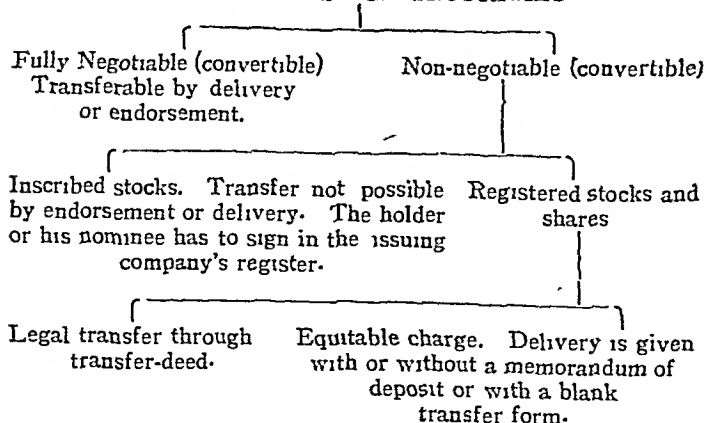
Collateral securities usually offered to a banker may be grouped under the following heads :—

1. Stock Exchange Securities

These consist of both Government securities and securities of the joint stock companies. They may be (a) fully negotiable (convertible) or (b) non-negotiable (inconvertible). The latter may, however, be again subdivided into (i) inscribed stocks and (ii) registered stocks and shares. Fully negotiable securities (convertible) are transferable by delivery or endorsement. In the case of non-negotiable inscribed stocks, however, when a transfer is made, an entry is required to be filled in either by the holder or his representative in the issuer's register, and hence they are not transferable by delivery or endorsement. The banker must, therefore, to perfect his title thereto get them transferred

into his name by inscription in the books of the issuer. Coming to non-negotiable registered stocks, they are evidenced by certificates given duly sealed by the issuing authority and may be transferred by means of either a *legal transfer* or an *equitable charge*. A legal transfer is effected either in writing or under seal by the execution of a transfer-deed and when it is sent with the certificates to the company, the banker is registered as the holder and a new certificate is issued. An equitable charge on the other hand is effected only by a deposit of certificates with or without a memorandum of deposit or a memorandum of transfer and duly executed blank transfer. A deposit of certificates is usually accompanied by a memorandum of deposit and duly executed blank transfer, as in cases of default the blank transfer can be filled and the shares, etc., got transferred in the banker's name. In the case of deposit of certificates only or a memorandum of deposit also, the banker has to call upon the customer in default and ask him to execute a legal transfer and on refusal he can obtain the sanction of a court for a transfer and for a power to sell the securities. This is surely not convenient for him, and hence it is not very popular.

STOCK EXCHANGE SECURITIES



Merits. (1) They are easily and quickly realisable.

(2) Their actual market value can be easily ascertained.

(3) Their value does not fluctuate violently.

(4) Their title is clear, and hence they are transferable without much difficulty.

(5) In the case of negotiable securities, the banker, if he takes them *bona fide* and for value, 'acquires a title against all the world to hold them until the obligation they were given to cover is discharged'.

(6) In times of need they can be pledged with the central bank without much difficulty for advances, from it.

Demerits. (1) In the case of a partly paid share or debenture, the banker may be called upon to pay the uncalled portion, as a failure to do the same usually leads to its forfeiture.

(2) Certain joint stock companies insert a clause in their article to the effect that they will have a first and paramount lien on their own shares for any debt due by their customers who happen to be their shareholders also. In such cases, a banker may find his right valueless if he finds at the time of their sale that there is a debt owed by his customer to the issuing company as well.

(3) If the securities are non-negotiable, there is much inconvenience at the time of transfer. The banker's title to them is the same as that of the transferor, and it is possible that they may turn out to be defective.

Precautions. (1) Sufficient margin must always be maintained. As soon as there is a fall in the value of the securities, fresh collaterals must be obtained or the amount of advance reduced.

(2) Partly paid shares and debentures should, on no account, be accepted.

(3) In the case of non-negotiable securities, as far as possible, transfer must be effected at the time of the advance.

(4) Speculative shares must be avoided.

2. Negotiable Instruments

We know that a bill of exchange can be discounted with a banker. When this is done he gets the full right over the same and may sell or re-discount it to or with anybody else. In case it is given as a pledge, this is not possible, and the banker must retain it till maturity. It is, therefore, always better from the banker's point of view if such securities are sold outright to him rather than be pledged.

Merits. (1) They give better title to the banker if taken in good faith.

(2) Their value is fixed.

(3) They may be re-pledged.

(4) Money is available at maturity.

Demerits. A negotiable instrument entails upon the banker the duty to realise its value on maturity.

Precautions. As far as possible they should not be accepted by way of pledge but rather be had on discount. This is necessary if the banker wants to have the right to re-discount them with the central bank.

3. Goods or Documents of Title to Goods

If goods are pledged with a banker they may be either kept in his godown or left in that of the borrower. In the latter case, it is necessary that the keys should be handed over to the banker. In both cases, insurance is required to be effected and the premium is payable by the borrower. In the former case, he is also required to bear storage charges. Documents of title to goods may also be pledged. These include, a bill of lading, dock warrant, warehouse keeper's certificate, wharfinger's certificate, railway receipt, warrant or order for the delivery of goods and any other document used in the ordinary course of business as proof of the possession or control of goods, or authorising, or purporting to authorise either by endorsement or delivery, the possessor of the document to transfer to receive goods thereby represented.

Merits. (1) Goods or documents of title to goods form tangible securities.

(2) Their value does not fluctuate widely.

(3) They can be sold very easily.

(4) Advances made on their basis are likely to be paid within a short period as they are held with a view to be sold at the earliest opportunity coupled with sufficient profits.

(5) Their value can be easily determined.

Demerits. (1) Goods are liable to deterioration and damage.

(2) Their value is subject to daily fluctuations though not widely.

(3) In certain cases, it requires an expert knowledge to make a correct estimate of the quality, and hence there are more chances of fraud.

(4) Some goods require a huge space for storage.

(5) There is a greater possibility of theft.

(6) As they are required by the borrowers in small lots according as they are sold by them, the banker is put to much inconvenience in giving delivery and keeping a record. There is a danger of mistake in releases as well.

(7) In the case of documents of title to goods, there is a possibility of forgery.

Reasons for their Unpopularity in India. (1) There are no licensed warehouses worth mentioning in this country.

(2) There is a lack of suitable grading in the case of many commodities. In others, it is not strictly adhered to.

(3) There is an absence of organised markets for certain staple commodities in various places and hence the difficulty in ascertaining their value.

Precautions. (1) Goods more liable to deterioration and damage must as far as possible be avoided. In case, they are accepted insurance should be effected against all possible risks. Bullion is perhaps the best of all the goods as far as freedom from the liability of deterioration and damage is concerned.

(2) Care should be taken to find out daily changes in the market value of the goods received on pledge and sufficient margin must always be maintained with a view to safeguard against losses due to fall in the value.

(3) An expert staff must be maintained with a view to ascertain the quality of the goods pledged.

(4) There should be strict supervision regarding releases. If possible a whole time clerk must be kept for this purpose.

(5) In cases of the pledge of documents of title to goods, care must be taken to ascertain that they are genuine. As far as possible attempts should be made to obtain evidence of the fact that the title of the borrower to the documents offered as security is good.

(6) A banker should accept only such goods in his godown as he thinks would be safe there. In case, they are to be left in the godown of the borrower himself, it should be thoroughly examined and defects if any must be removed. As far as possible cemented granaries must be given preference over ordinary granaries.

(7) The banker must also satisfy himself above all with regard to the honesty, integrity and prudence of the borrower. He must be experienced in the line of his business.

(8) The banker should also be careful in dealing with agents and employees. Their authority to borrow and pledge must always be determined.

(9) In all cases, an evidence of the pledge must be obtained in writing.

(10) There are several copies of a bill of lading. Hence, when this is accepted as a security, all copies must be obtained with a view to protect against fraud.

4. Life Policies

If there has been no misrepresentation, or inaccurate information at the time of the proposal, life policies form a good security against advances on the basis of the actual surrender value. But they do not figure prominently in the list of the bankers' securities these days, as Life Insurance

Companies themselves are always prepared to make advances on their basis, and it is much more convenient for a borrower to approach them than the bankers. There may be an equitable or legal mortgage in this case as well. The former means here the submission of the policy itself with or without a memorandum and the latter means the filing of a 'deed of assignment,' the operative part of which includes covenant by the borrower for repayment of principal and interest, and an assignment of the policy subject to a promise for a redemption.

Merits. (1) Their value can easily be ascertained. On the back of a life policy itself a mode of the determination of surrender value is given. It can also be found out by reference to the Insurance Company.

(2) The value of a life policy goes on increasing as the time lapses, provided of course premiums are being paid regularly.

(3) Where a policy has been deposited even without a memorandum, and the depositor becomes bankrupt, the trustee in bankruptcy cannot claim the policy without satisfying the claim of the banker.

(4) A life policy automatically matures on the borrower's attaining a certain age or in the event of his death.

(5) If a policy has been assigned and notice given to the insurance company, it provides a complete security. There is no difficulty in proving the title.

(6) It can be assigned by a banker to a third party as security for an advance.

Demerits. (1) The validity of the policy may be questioned at the time of payment in case it turns out that the assured had not disclosed all the material facts in the proposal form.

(2) In case the age of the assured had not been admitted, it might become extremely difficult for the banker to prove the same in the event of his death.

(3) Cases of suicide and death by the hands of justice are not usually covered by an insurance policy.

(4) In case a policy is taken out by the assured to

provide for his wife and children, it may not be good for the reputation of the banker to put his claim against the widow and orphans.

(5) The value of a policy increases only by the continued payment of the premia. If they are not paid by the assured, the banker might be required to make the payment himself.

(6) If the policy has been taken by a third person, it may become void in the absence of an insurable interest.

(7) If the policy has not been taken possession of, it is possible that a subsequent mortgagee may obtain a prior right of assignment to the banker giving earlier notice and obtaining its possession.

Precautions. (1) The banker should see that the age of the assured has been duly admitted and must obtain a copy of the proof of such admission.

(2) He must also examine whether the person taking the policy on the life of the assured had an insurable interest in it at the time of the taking up of the policy or not.

(3) He must insist on a legal mortgage rather than be satisfied by an equitable mortgage.

(4) He must see that premium receipts are constantly deposited with him and that the policy is not allowed to lapse.

(5) He must also give a notice of the mortgage charge to the insurance company and enquire whether a notice of any other prior claim has not already been given.

(6) An endowment policy is better from the point of view of a banker than a whole life policy.

(7) In case of a policy in the name of a woman since married a certificate of marriage should also be obtained.

(8) Various clauses in the policy must be thoroughly gone through with a view to ascertain his own rights and liabilities.

Immovable Property

When immovable property is offered for security, it

is required to be mortgaged, and as has already been observed previously, it will be usually a legal mortgage, an equitable mortgage being allowed only in certain places and not giving right of sale. The deeds must be examined by a competent authority with a view to ascertain their genuineness and correctness. Care should be exercised in valuing the property and as far as possible experts should be appointed for this purpose. Insurance must also be effected.

Merits. In fact, immovable property has got no merit to be accepted as cover against advances, but as there are some customers who cannot offer any other thing, it has to be accepted.

Demerits. (1) Legal mortgage is both expensive and inconvenient. Equitable mortgage is not allowed everywhere in this country.

(2) It is difficult to find out the title of an immovable property because of the peculiarity of both Hindu and Mohammedan Laws of Inheritance.

(3) It is difficult to form a correct estimate of the value of an immovable property. Again, the same is subject to heavy fluctuations.

(4) There is a good deal of difficulty in realising it. A number of legal formalities are required to be observed. It also takes a good deal of time to find out a purchaser. Different values are attached to the same property by different persons and at different times.

(5) Certain classes of house property rapidly deteriorate in value if they are not kept in a proper condition of repair.

(6) From the time of the acquisition of a house property on the expiry of the period of debt to the time of its sale to somebody else, the banker has to find out tenants and arrange for repairs.

(7) It is extremely difficult and inconvenient to find out whether the deed to an immovable property is genuine and correct.

(8) In cases of leasehold property, there is always

the danger of the forfeiture of the lease due to non-payment of the ground rent.

(9) There is a danger of a loss to the property by fire.

Precautions. (1) Sufficient care should be exercised at the time of the determination of the title of the borrower to the immovable property offered by way of security.

(2) The deeds should be immediately submitted to a competent authority for close examination.

(3) Provision must be made for future repairs.

(4) In cases of a leasehold property provision must also be made for the periodical payment of ground rent.

(5) All house property must be insured against fire, and the borrower should be asked to produce for the banker's inspection receipts for each annual premium.

(6) Second mortgages should be avoided, and if notice of the same be received from somebody else, the banker with whom a first mortgage has already been made, should cease to make further advances, as all such advances will create a charge postponed to the second charge of which notice is received.

TEST QUESTIONS

1. What do you understand by the term 'advances'? Explain the meaning of continuing and specific guarantee or surety in this connection.

2. What do you understand by the term 'collateral securities'? What form they may take? State the points of difference between each.

3. What are different types of collateral securities usually accepted by a bank? Write a short note on the characteristic features of each.

4. What are the merits and demerits of stock exchange securities as collaterals from the banker's point of view? Suggest measures for minimising the latter.

5. Discuss the merits and demerits of goods and title to goods as collaterals. What precautions should be taken while

CHAPTER XI

BANKERS' CLEARING HOUSE

A bankers' clearing house is an institution of credit where reciprocal liabilities of the local banks are counter-balanced against one another. As has already been observed in Chapter VI, the function of the settlement of clearance balances between the banks has been adopted by all central banks as a matter of course or as a duty laid down by law. In some of the countries where clearing arrangements had been made long before the establishment of a central bank by the commercial banks themselves, or where the central banks did not take initiative in the matter in the beginning, there are independent clearing house institutions with constitutions and premises of their own. But there too, the central banks, apart from being their members, have to perform also the function of settling the differences between the banks at the end of each clearing. In others they usually provide for clearing house accommodation, frame rules for the conduct of the operation, supervise them and finally perform the function of settling the differences as well. Illustrations were given from the practices in England and India. In the same connection, it was also said that by our experience we find that the cheques, etc., drawn on any bank and presented by other banks on behalf of their customers for payment over any period tend to approximate closely the cheques, etc., on them received from its own depositors. In fact, it is upon this principle that the bankers' clearing houses have been established.

PROCESS OF THEIR WORKING

The process of working in them is very simple. Suppose there are four clearing banks, namely, A, B, C and D. Each of these banks keeps specially ruled sheets known as *Summary sheets of out-clearing*, wherein the records of all cheques or bills which it has to realise from other banks are made. Thus, if bank A on sorting cheques and drafts

in its possession, finds claims against bank *B*, it will enter the same on the sheet. Claims against other banks will be similarly entered. A separate sheet is used for each individual bank. After this, the cheques, etc., are carefully checked and bundled up separately. These bundles are then taken to the clearing house and put on clearing desks of the above four banks respectively. There, the clerks of the respective banks make their record, in the *Summary sheets of in-clearing*, in the same way as the record had been made in 'summary sheets of out-clearing' as referred to above. If the total of out-clearing of bank *A* against bank *B* is greater than the total of its in-clearing from the other, it has to receive a balance, and *vice-versa*. Then, these balances as shown by the sheets are entered upon a list known as the *General Balance Sheet* of the particular bank. This list contains printed names of the above banks with Dr. and Cr. money columns on the left and right sides respectively. If an amount is to be received from a bank, it is entered on the debit side just in front of the particular bank's name and *vice versa*. A balance is then struck out of the debit and credit totals and instructions for transfers are given to the central bank. For instance, if bank *A* has to receive a balance, it directs the central bank to transfer the same from the clearing house account to its own account and *vice versa*. Thus the entries in the accounts of the clearing banks with the central bank are made as also with the entries in the account in the name of clearing house. It must also be noted that the cheques upon different banks are sent to their respective offices and in case any of them is refused there, it is treated as an out-clearing for the refusing bank.

ADVANTAGES

This organization is advantageous both to the bankers and society at large. It is advantageous to the bankers inasmuch as they are not required to send their men to each bank separately. Neither are they required to receive or pay in cash unnecessarily. This provides for an additional advantage, viz., that of the necessity of keeping not very large sums in hand. It is advantageous to the society also as it can do with less amount of cash. It benefits by the extension of credit as well due to the increasing use of

cheques encouraged by their settlement through this system.

ENGLISH CLEARING HOUSE SYSTEM

In England, as was pointed out in Chapter VI, there are independent clearing houses in London and eleven provincial towns, and in the former and seven of the latter, where the Bank of England has got its office and branches respectively, the banks settle their clearing differences by cheques drawn on their accounts with the Bank of England in these respective places. But in the four towns where there are clearing houses but no branches of the Bank, differences are settled between the head offices of the banks in London by cheques drawn on their accounts with the London office in the same way as London clearings.

London Clearings

London clearings are divided into three sections :—

(1) Town clearing, (2) Country clearing, and (3) Metropolitan clearing.

(1) The *town clearing* covers an area within easy walking distances from the Bank of England. Ordinarily, two clearings are effected each day, one in the morning and the other at the afternoon. Each clearing bank sends round to the clearing house at the time fixed bundles of cheques known as charges—each for different banks. These are exchanged, entered and added and so far as possible the totals are verified¹. A balance is then struck out from the in-clearings and out-clearings from and to each bank. This, then is entered on the General Balance Sheet on the debit or credit side as the case may be, just in front of the name of each bank printed therein. The two columns are then added up and the difference represents the total sum owing to or by the bank in question on general balance. Each bank keeps an account at the Bank of England and there is also an account called the clearing banker's account and the differences are settled by transfers between these accounts.

¹The actual process has already been explained previously.

ment of the Reserve Bank of India, the conducting authority in them being naturally the Imperial Bank of India which managed all affairs on behalf of all the members. Since the establishment of the Reserve Bank of India, however, the same has taken the conducting authority of some of them on its own shoulders. But there are even now two places, *viz.*, Calcutta and Cawnpore where in spite of having its own office and branch respectively it has left the conduct of this operation on others. The members do, however, settle their clearing differences in all these places by means of cheques drawn on their accounts with it only. But there are places where the Reserve Bank of India has neither an office nor a branch, and hence in them Imperial Bank of India is not only the conducting authority but also the agency for the settlement of differences thereof. With the development of banking habit and use of cheque currency, more clearing houses shall have to be established. In some of the important towns, the business might be required to be divided here as well into sections as in London. The Reserve Bank of India and the Bankers' Association being alive to the need may be expected to take the necessary steps when required.

CLEARING HOUSES IN OTHER COUNTRIES

The American clearing houses render very valuable services. They fix the minimum rates of interest to be paid to depositors, issue certificates to banks on the basis of which they can borrow, and do sundry other things. On the continent of Europe too, almost in every country there are clearing houses, though the work in them is not very heavy because of the lesser use of cheques and crossings over them than in England and Wales.

TEST QUESTIONS

1. Define a clearing house and mention the part played by central banks in this connection. On what principle does it work?
2. Describe briefly but clearly the working of a banker's clearing-house. Illustrate your answer by means of an example.

BOOK II

BANKING IN INDIA

CHAPTER XII

HISTORICAL REVIEW

Banking, as we understand it at present, has developed in India only during the British rule. But this does not mean that there was a complete absence of the activities included in this term in our country before its advent. We have got evidences regarding the existence of money-lending operations from the Vedic period (2000 B. C.) onward. The word 'Rina' (debt) is found at several places in Rigveda and Atharvaveda. There is a mention of money-lenders called *Sethis* in Buddhist Jatakas as well which according to V. Smith may be taken to refer to the fifth and sixth centuries B. C. The money-lenders of Sarsuti lent to the Government of Firoz Shah (1351—88) huge sums of money which were used for payment to the army. There is a mention of the credit instruments also. We have a legend of the times of Lord Krishna to the effect that Narsinha Bhagat of Junagarh drew a hundi on Seth Samalshah of Dwarka. This may not be true as 'there appears to be no reference of hundis or bills of exchange'¹ so far as Buddhist literature or Sutras were written. But there are traces of the issue of letters of credit by big merchants in a few towns. Deposit business too seems to have developed to some extent though not considerably by the time of Manu, about the second or third century A. D., as he devotes a special section to the subject of 'Deposits and Pledges' in his Smriti. Money changing business too must have developed much earlier though it assumed importance only during the Moghul period when coinage had been undertaken on a very large scale; and numerous coins, some of the same denomination but all differing in market value, had come

¹L. C. Jain, *Indigenous Banking*.

the indigenous bankers³ owing to their ignorance of the language used by them.

(2) The attitude of the indigenous bankers also did not change. They followed their own methods and were concerned only with the granting of credit to the agriculturists and the artisans and the financing of the internal trade of the country.

(3) Though for a considerable time the East India Company successfully prevented the establishment of banks in this country on Western lines but gradually they had to be established and offered a keen competition in certain spheres of the banking business performed by the indigenous bankers.

(4) The indigenous bankers suffered due to the continuous warfare and chaos that resulted from the break-up of the Moghul Empire. 'There is historical evidence that the indigenous bankers' claims on ruling princes were sometimes evaded or not satisfied'

(5) The indigenous bankers also resorted to various malpractices which brought for them a bad name, and thus contributed to their decline.

(6) They lost their profitable money-changing business after the universalisation of the British Indian rupee throughout the country in 1835.

(7) The diversion of trade from old to new routes and the change in the basis of India's trade relations with other countries that were brought about by the development of railways, steamships, post and telegraph, also affected the business of these people adversely.

ESTABLISHMENT OF THE BANKS OF MODERN TYPE

Most probably the credit of starting the first bank

³The term Indigenous Bankers may be supposed to mean here all classes of people trading in one form or the other in money on the most antiquated method. For a further discussion please consult it in the next chapter.

of the modern type goes to the Province of Madras.⁴ It was a Government institution managed by its officers belonging to the Council. The bank was probably started in 1688. The next attempt was made in Bombay in 1724, by the Government, and as a result of this effort a second bank of the type-under reference was opened in that city in the above mentioned year. Later on several private banks were established in Madras along with one more Government bank. These were originally the banks of deposit and discount, though later on they began to issue notes also. In Bengal, the first banks of this type were those started by Calcutta Agency Houses. They were mainly trading concerns interested in tea and indigo. Banking was only an adjunct. Alexander & Co. along with several others was responsible for starting the Bank of Hindustan in 1770. The Bengal Bank and General Bank of India came into existence sometime in 1786, the former being, of course, not connected with any agency house and *Calcutta Gazette* of March 16, 1786 prohibited it from engaging in commerce. The latter, as far as is known, was the first Joint Stock Bank with limited liability in the whole of the Empire as this principle was applied even in England as late as 1855 and then, too, banks were excluded from this privilege. It was only after the crisis of 1857 that it was extended to the banks but care was taken to exclude notes from it. In India, the privilege was incorporated in the Indian Companies Act of 1861.

The General Bank of India grew in importance. It was soon appointed bankers to the Government. Its management was the most efficient and this was responsible for giving it headway over its rivals, specially the Bank of Hindustan and the Bengal Bank. "But with the currency difficulties of 1787, ill-informed aspersions and unjust criticisms were cast on it. After the famine of 1788, it could not lend money to the Government at the usual rate of 8 per cent. Government connection, therefore, with the bank was severed in 1789. The bank was

⁴In most of the text books it is given to the Agency Houses of Calcutta. They are evidently wrong.

voluntarily dissolved by liquidation on 31st March, 1791." By the end of the year the Bengal Bank had also to go into liquidation because of its inability to meet the runs. The Bank of Hindustan survived. It resisted very successfully not only the run of 1791, but also those of 1819 and 1829. But in the end, it also failed in 1832 in consequence of the failure of the Alexander & Co. with which it had been intimately connected since its inception. Other banks also started by these Agency Houses and intimately connected with one or more of them had to meet the same fate. 'The Calcutta Bank which had been opened by Messrs. Palmer & Co. had already failed in 1829 and the Commercial Bank of Calcutta also went to the wall with Messrs. Mackintosh & Co., in 1833.' All these banks issued notes and hence their failures brought complete ruin not only to the depositors who included many widows and pensioners but also the note-holders. All these were European enterprises and hence the blame of their failure cannot be put on the shoulders of the people of this country.

Presidency Banks

The Bank of Bengal,⁵ the first of the Presidency Banks, was established in 1806 as the Bank of Calcutta, and received its charter as the Bank of Bengal in 1809. The principal object of starting this bank was 'to render service to the public without incurring any great risk and without causing any kind of inconvenience, and help the East India Company's Government in its financial embarrassment if and when required.' It was also one of the objects of the bank to supply specie cheaply. In 1823, it was allowed to issue notes and in 1829 to open branches and to deal in in-land exchange, but not in foreign exchange. The Government of Bengal contributed about one-fifth of the capital also with a view to be able to share in the direction of the business so as to keep it within safe limits. The secretary of the bank was usually a member of the

⁵This bank was quite different from the Bengal Bank which was started in 1786 and liquidated in 1791 as already mentioned.

civil service, and some of the directors were appointed by the Government.

The Banks of Bombay and Madras were established in 1840 and 1843 respectively with a contribution of some part of the capital by the Governments of the respective provinces and along the lines of the Bank of Bengal. They also issued notes. The three Presidency banks were given the monopoly of Government banking. The privilege of note-issue was, however, snatched from them in 1861 by the Government of the country as it undertook the monopoly of this business in its own hands in this year. As a compensation for the usurpation of the right of note-issue, it gave them the use of its balances in the Presidency towns and at their branches⁶ free of charge.

In the year 1868, there occurred an event which changed the relationship of the Government with the Presidency Banks. The Bank of Bombay had become involved in the speculative activities of 1862—65 that followed the American Civil War and the rise in the price of cotton, and suffered serious losses. This led to its voluntary winding up and the establishment of another bank immediately and having the same name, with a capital of Rs. 1 crore. No doubt, the depositors could be paid in full, but the shareholders got almost nothing. The Government thereafter withdrew its capital from the other two banks also and ceased to take part in the management and appointment of directors etc. A Commission was appointed to examine the causes of the failure of the bank and its report led to the passing of the Presidency Banks Act of 1876 which contained provisions regarding restrictions on their business. They may be briefly stated as follows :

(i) They could not undertake foreign exchange business.

(ii) They were prohibited from borrowing or receiving deposits payable out of India.

(iii) They could not lend for a longer period than six months.

⁶In some text books mention has been made of only the Presidency towns and not their branches. This is wrong.

(iv) They were forbidden to lend upon mortgage or on the security of immovable property or upon promissory notes bearing less than two independent names or upon goods unless the goods or titles to them were deposited with the banks as security.

They no longer enjoyed the full use of the Government balances. Reserve Treasuries were constituted at the Presidency towns into which the surplus revenues were drawn and the balances left at the disposal of the banks were strictly limited.

Notwithstanding the fact that these banks received deposits, discounted inland bills and managed the public debt of India, it was realised that their popularity was confined to the Presidency towns or, at the most few commercial centres in their respective territories. They suffered from serious shortcomings, the most important of them being as follows :—

(1) There was no co-ordination between them at all. As early as 1836 the demand for converting the Bank of Bengal into a 'Bank of India' had been placed before the Court of Directors of the East India Company. During the years 1860 to 1876 again it was renewed. In 1898 some witnesses before the Fowler Commission advocated the establishment of a central bank. In 1913 the Chamberlain Commission suggested the appointment of a small expert committee in India to examine the question. During the First War period the absence of one bank for the whole of the country was keenly felt.

(2) They started branches only in places where they were certain to get profit. At the time of amalgamation they had altogether only 59 branches.

(3) They did not possess sufficient funds for financing the trade of the country. Their combined capital was Rs. 3 $\frac{3}{4}$ crores, reserve Rs. 3,77,79,000 and deposits Rs 87,04,53 000 at the time of amalgamation in 1920. Most of the Government balances lay idle in its treasuries and sub-treasuries.

(4) There was no provision for the contraction and expansion in the volume of note-circulation according to

the trade demands of the country, and this led to violent fluctuations in the rates of interest and discount. The Government controlled currency while the credit was controlled, if at all, by the Presidency banks and there was no connection between the two.

(5) The first two restrictions were imposed on the banks to preclude them from a risky type of business, but they were continued even after the stabilisation of the exchange rate. "The first joint memorial of the three Presidency banks presented in 1877 demanded permission to borrow in London and India and to deal in foreign exchanges. A conference was held in 1899 to discuss these points of grievance but nothing came out of it, in spite of the fact that public opinion condemned the retention of these restrictions. The plea in favour of borrowing in London was always summarily rejected without due consideration of the merits of the case."

(6) They did not fulfil the functions of a bankers' bank and a lender of the last resort. They were not strong enough to support the whole burden. Yet they could have done something by indicating their intention to stand behind, at any rate, the more deserving Indian banks.

Independent Commercial Banks

After the year 1833 on the failure of the banks started by agency houses, independent commercial banks were established in this country. These were based on unlimited liability principle upto the year 1860. C. N. Cooke mentions of the opening of twelve banks and dying out of about half of them during this period. "Now, as the agency houses which acted as bankers to the civil and military services had been swept away in the crisis of 1829—32, need was felt to have some other credit institutions for the benefit of the members of these services and the Agra and United Service Bank, and the Government Savings Bank, Calcutta, were almost immediately opened for this specific purpose. Later, the Agra Savings Bank and the Uncovenanted Service Bank were established."

⁷L. C. Jain, *Indigenous Banking*.

Among the causes of their failures may be mentioned speculation and fraud. This was due to the loose auditing of accounts which obtained in those days. Effective audit is always indispensable to the growth of healthy banking. Some of the banks of this period, no doubt, gave a good account of them.

The year 1860 marks a new era in Indian banking as by an act of that year the principle of limited liability was first applied to the joint stock banks of the country. This together with the increased prosperity, because of the high prices of cotton due to the complete stoppage of its supply from America as a result of the Civil War there, led to the establishment of about twenty-five banks during the course of specially the year 1861-65. But they were all short-lived and collapsed as soon as the speculation itself to support which they had arisen ceased to exist. The Bank of Upper India established in 1863, however, survived till 1914.

The period from 1865-1905 was a period of quiescence and very few banks were established during these 40 years. But of those which were established some have played an important part in the banking history of the country. The Allahabad Bank which was opened in 1865 still survives and is one of the five biggest banks of India. The Alliance Bank of Simla was founded in 1871. It had a very brilliant career and closed its doors in 1923 mainly due to misfortunes. An estimate of its position may be made from the following figures relating to the year 1921 :—

Paid-up capital	...	...	Rs.	88 lakhs
Reserve	...	...	Rs.	53 lakhs
Fixed deposits	...	...	Rs.	900 lakhs
Current deposits	...	...	Rs.	679 lakhs
Total deposits	...	...	Rs.	1,627 lakhs
Cash balance	...	...	Rs.	439 lakhs
Branches	...	...	36.	

The Oudh Commercial Bank was registered in 1881. Its head office is at Fyzabad. It is a scheduled bank. The Punjab National Bank was floated in 1894, and is at present one of the big five of the country. The People's Bank was started in 1901 and liquidated in 1913. Its sole

aim was to promote and maintain industrial enterprises on 'Swadeshi' lines. "The circumstances in which it undertook to do this were not favourable. Industries were either conspicuous by their absence or in very immature stages of growth. The managing director, therefore, became the promoter and manager of several enterprises and the result was, as it is, when banking and entrepreneurial functions are combined without strict adherence to the necessary banking practices." An estimate of its position may be made from the following figures relating to the year 1910 :—

Paid-up capital	...	...	Rs. 11·5 lakhs
Reserves	...	...	Rs. 1·8 lakhs
Deposits	...	...	Rs. 98·4 lakhs
Cash credits, bills, pro-notes, over-drafts	...	...	Rs. 79·3 lakhs
Deposits with other banks	...	...	Rs. 2·4 lakhs
Drafts in hand	...	...	Rs. 1·9 lakhs
Debentures and other investments	...	...	Rs. 4·2 lakhs
Government paper	...	...	Rs. 4·2 lakhs
Cash in hand and at bank	...	...	Rs. 7·1 lakhs

The failure of banks in 1865 broke the spirit of the entrepreneurs. The banks involved were managed by both Indians and Europeans. We know that even such a strong bank as the Bank of Bombay was put to disgrace and liquidation in 1868 mainly as a result of the speculative panic of 1865. But there was another cause for the quiescence which fully explains the situation. We know that the gold price of silver began to fall after the seventies, and India being then on the silver standard, every fall in the value of silver altered the rate of rupee exchange. This increased the element of uncertainty in the foreign trade of the country and affected her industries. This continued upto 1893. The currency troubles affected joint stock banking doubly. Firstly, attention was diverted during this period towards the stabilisation of the monetary unit to the exclusion of the development of banking and secondly, the uncertainties of trade created such conditions and atmosphere in the country's money market as were unfavourable to the promotion of new banking ventures.

Then, came the wave of the Swadeshi movement of

1906—13 which was responsible for the floatation of 98 banks during the period. A number of them were small and fell in the period beginning after the year 1913 and lasting upto 1919. But most of the existing important joint stock banks were also established during this period. Of the present day big five, it has already been pointed out that two had been established during the previous period. The remaining three were established during this period. The Bank of India was registered in 1906, the Bank of Baroda in 1909, and the Central Bank of India in 1911. Amongst the other banks established during this period and surviving to the present day may be mentioned the Indian Bank (1907), the Punjab and Sind Bank (1908), and the Bank of Mysore (1913). All these are scheduled banks.

War and post-War boom gave another impetus to joint stock banking. The Tata Industrial Bank was founded in 1918. It showed signs of a very promising career. But due to the mistake of combining long-term business with ordinary banking transactions and also on account of the inexperience of the majority of European employees who controlled its affairs and the apathy of the general public and Indian staff consequent thereupon, it failed and was merged with the Central Bank of India in 1923. The Industrial Bank of Western India, the Kanani Industrial Bank, the Union Bank of India and several others which survive to this day, and are scheduled banks were also found during this period. But there were many more which were established only to increase the number of failures. No doubt the severity of the crisis of 1913—19 had subsided, but the toll of bank failures continued even during the period of 1919—25. In all 81 banks with a total of Rs. 51 crores of capital were involved in it, and as has already been pointed out such distinguished banks as the Alliance and the Tata were affected.

During the period that followed and extends to this day many big and small banks have been established. The growth has been very remarkable specially since 1940. The main factors responsible for this are "the general confidence engendered by the improvement in the war situation, the

increased tempo of war economic activity and the rapid increase in currency circulation due mainly to the enormous purchases of material by the Government of India on behalf of Allied Governments." The number of joint stock banks with a capital and reserve of over Rs. 5 lakhs rose from 28 in 1926 to 58 (41 scheduled and 17 non-scheduled) in 1940 and to 98 (72 scheduled and 26 non-scheduled on 30-6-45) that of those having a capital and reserve of Rs. 1 lakh and under Rs. 5 lakhs from 47 in 1926 to 120 in 1940 and 152 in 1943 and that of those having a capital and reserve of over Rs. 50,000 and under Rs. 1 lakh from 121 in 1910⁸ to 141 in 1943. Of course, the number of banks having a capital and reserve of under Rs. 50,000 has been going down, as since 1936 no such new banks can be started and old ones have been increasing their capital and reserve. In 1940, they numbered 332 and in 1943, 133.

Failures too have been many, ranging from 18 to 102 from 1931 to 1943—the lowest being in 1931 and the highest in 1940. Before the passage of the Indian Companies Amendment Act, 1936, bank failures never had much significance in India, as prior to that no effort had been made either to define the word 'bank' or to ensure in any other manner that only responsible concerns used that description in their title and as such any and every concern could get itself registered as a bank and when and it failed, served to swell the number of so called bank failures. The mortality in a considerable number of cases was confined only to the infants and the young. Banks only with a small capital failed. Of course, the failure of the Bank of Upper India, the Alliance Bank of Simla, the People's Bank, and the Tata Industrial Bank stands on a different footing. Since 1936, however, bank failures has considerable significance. But in this case as well mostly weaklings have suffered—there were a few important banks also, viz., Sivarama Ayyar Bank, Madras, the Bengal National Bank, the Travancore National and Quilon Bank and the Benares Bank. Their failure is regrettable and specially because they were scheduled banks.

⁸Figures for 1926 are not available.

Imperial Bank

It has already been noticed that the absence of co-ordination between Presidency banks had been keenly felt and the demand for one central bank for the whole of the country had been continuously pressed from as early as 1836. As a result of this an Act was passed in 1920 bringing about their amalgamation into the Imperial Bank of India. Under the scheme the paid-up capital of the new bank was fixed at Rs. 5·62 crores. Its public character and responsibilities were also secured. Out of the 16 members of the Central Board, who were designated as Governors¹¹ 10 were to be appointed by the Governor-General in Council, as will be clear from the following constitution embodied in the Act :—

(1) Nominated by the Governor-General in Council :—

(a) Two Managing Governors, of course, after the consideration of the recommendation of the Central Board.

(b) Four Governors—non-officials representing the interests of the Indian community in general.

(c) Three secretaries of the three local boards of Bombay, Calcutta and Madras.

(d) The Controller of Currency.

(2) Elected by the shareholders.—The presidents and the vice-presidents of the three local boards.

The Government could also issue instructions to the bank in any matter which in its opinion, vitally concerned its financial policy or the safety of its cash balances. It could also call for any information from the bank regarding its affairs, documents, and statements of its assets and liabilities. It could also appoint any auditors to examine and report on its accounts. Finally, its previous sanction was necessary for establishing more local offices and boards.

An agreement was entered into between the bank and the Secretary of State for India, which provided that

¹¹They are now designated as directors, *vide* Imperial Bank Amendment Act, 1934.

the former would conduct all general banking business of the Government and manage its public debt, and open within five years of its commencement a hundred new branches, the location of twenty-five of which could be determined by the Government. As against this, it was permitted to hold all the treasury balances, wherever it had a branch office and get its funds transferred through currency, free of charge. Besides, the Government agreed not to issue any 'currency transfers' or 'supply bill' between any two places where a branch of the bank might be located. The bank, in return, undertook to offer every facility to the public for transfer of funds from one branch office to another at rates not higher than those approved by the controller of the currency.

The law also laid down the business that the bank could not undertake. With a view to enable it to assist the money market in the busy season, the Paper Currency Department of the Government was authorised to grant loans to it upto a maximum of Rs. 12 crores at the bank rate subject to a minimum limit of 6% for the first Rs. 4 crores and 7 % for the remaining Rs. 8 crores, on the security of the inland bills or hundis of an equal amount.

But the question of establishing a full fledged central bank for India was raised again and again, and finally the Hilton Young Commission recommended in clear terms the establishment of such an institution over and above that of this bank. The creation of the Reserve Bank of India in 1935 gave effect to this recommendation.

Foreign Banks

In addition to the banks founded in this country, a number of foreign banks with head offices abroad have carried on business here through branches. Until 1853, the East India Company supported by the agency houses succeeded in preventing the commencement of such banks with the only exception of the Oriental Banking Corporation in 1842, as they were afraid that the banks would profit at their expense on the plea that Act 47 passed during the reign of George III had given to the Company the power to incorporate such banks and limited the royal prerogative

to grant charters to them. By 1853, however, it was decided that the Act under reference empowered it to incorporate banks merely for transacting general banking business within its territories and did not limit the royal prerogative to grant charters to banks for carrying on the business in India. Hence, in this year, the Chartered Bank of India, Australia and China, and the Chartered Bank of Asia (afterwards the Mercantile Bank of India, London and China) were brought into existence by Royal Charter. The Oriental Bank failed in 1864, the Mercantile Bank had to abandon its Charter in 1893 and was re-organised, leaving only the Chartered Bank of India, Australia and China, of all the banks constituted under a Royal Charter, to continue doing business here. In 1863 was formed the Calcutta Banking Corporation with its head office in Calcutta but next year it changed its name to the National Bank of India and shifted its head office to London two years later. Of the other English and foreign banks which are doing business at present in India, the Comptoir National d'Escompte de Paris was started in 1862, the Netherlands India Commercial Bank in 1863, the Hongkong and Shanghai Banking Corporation in 1864, the Yokohama Specie Bank in 1894, and the Eastern Bank in 1910. In all there were 12 such banks doing business here in 1913. Within 1919—21 about six new banks were added. At present there are 16 such banks the Imperial Bank of Prussia having closed its branch at Bombay in 1934, and the Thomas Cook and Son (Bankers), Ltd., having been absorbed by Grindlay & Co., in 1944.

Co-operative and Land Mortgage Banks

Besides the above banks which have formed the main components of the Indian banking system, there have been established in the country Co-operative and Land Mortgage Banks. The co-operative movement dates from 1904 when the first Co-operative Act was passed. In 1912 another Act to bring co-operative societies on better basis was passed. They are started with the aim of facilitating credits for the Indian cultivators, and receive deposits and contract loans which they advance to their members, as and when necessary, in proportion to their worth and requirements. The

number of the principal co-operative banks having paid up capital and reserve of Rs. 5 lakhs or over was 8 in 1925 and 42 in 1943, and that of those having paid-up capital and reserve over Rs. 1 lakh but less than Rs. 5 lakhs was 90 and 303 respectively. Besides, there were in the later year small co-operative institutions whose number extended to about $1\frac{1}{2}$ lakhs. The number of the land mortgage banks and societies in this year was also more than 200.

Post Office Savings Banks

The present survey will not be complete without an account of the post office savings banks. There are no independent savings banks in India like those of other countries. The Imperial Bank of India and most of the other banks have, however, opened savings bank departments. In the beginning the Government started savings banks in the Presidency towns, and later on district savings banks were also opened. But in 1882 the *Post Office Savings Banks* were established, and these gradually absorbed the business of the former types of savings banks. Post offices provide, in fact, facilities for saving and investment in four ways, viz., (i) by receiving deposits in their savings banks, (ii) by issuing postal cash certificates, (iii) by purchase and sale of Government securities for the public free of charge, and (iv) by offering life policies to Government servants and employees of the universities. As a war measure, 10 year Defence Savings Certificates and later on 12 year National Savings certificates, and Post Office Defence Savings Bank accounts have also been introduced. At the end of the year 1943-44 the total amounts outstanding in connection with the P. O. Cash Certificates including Defence Savings certificates and National Savings Certificates and P. O. Savings Bank including Defence Savings Bank account for the whole of India amounted to Rs. 50.26 crores and Rs 68.22 crores respectively.

Loan Offices Nidhis and Chit Funds

The above are the agencies spread all over India. But there are certain other agencies also which are found

only in certain provinces, *e.g.*, loan offices of Bengal and Nidhis and Chit Funds of Madras. The loan offices of Bengal were first started there on the lines of land mortgage banks. - They receive deposits. Their main function is to lend money to landlords and actual cultivators against the security of land or any other valuables. Personal security is also popular with them. A few finance trade and industry (specially tea gardening). They combine money-lending with trade as well in certain cases. The 'Nidhis' were started in Madras first of all as mutual loan societies. They have, however, developed some of the modern banking functions as well, and receive deposits and make loans to non-members also. The 'Chit fund' is a loose organisation of some people and serves as a very useful mechanism for promoting thrift and investment habits. The members agree to make periodical payments to one of themselves who is the promoter of the 'Chit' and keeps the first collection himself by way of remuneration. Each successive collection is then given to one of the members usually in rotation, the order being decided by lots.

TEST QUESTIONS

1. Give in brief the evolution of the banking system in this country and show its importance in the mediæval period. What were the causes of its decline afterwards?
2. Write a short note on the modern types of banks first established in this country. What was the cause of their failure?
3. Give a brief historical survey of the Presidency banks. What businesses were prohibited to them? Discuss the shortcomings with which they suffered.
4. Discuss in brief the establishment and failure of modern banks since 1833, bringing about the salient features of each period. What do you think was the cause of the quiescence in the period 1865—1905?
5. Write a short note on the establishment and working of the Imperial Bank of India upto the year 1935, with special reference to its obligations and privileges.

CHAPTER XIII

INDIGENOUS SYSTEM OF BANKING

Having discussed in brief a historical review of banking in India, we shall now make a critical study of its components. First of all, there is a heterogeneous class comprising of the rural and urban money-lenders of various types, and people dealing in money and credit in different ways. They are known by different names, *e.g.*, the Bania, the Mahajan, the Sahukar, the Sarraf or Shroff, and the Kothiwala, and are spread all over the country. There is no reliable statistical data regarding them but it is estimated that their number must be somewhere between 3 and 4 lakhs. They belong to all castes but are principally Agarwals, Jains, Marwaris, Chettis, Khatris, Aroras, Multanis and Bohras. Amongst Mohammedans are the Kabulis and the Pathans.

MEANING OF THE TERM 'INDIGENOUS BANKING' OR 'INDIGENOUS BANKERS'

The word 'indigenous' meaning 'native born' or 'produced naturally in a country', the term 'indigenous banking' may be applied to a system of dealing in money evolved in this very country and 'indigenous bankers' to people doing this business. This may be taken to mean the system of banking and bankers in contrast to alien or foreign which comprises of modern banking and bankers. From this, it follows that the people doing business on the lines of English system of banking though belonging to this country cannot be called indigenous bankers. The term can be applied only to such as have been doing business on purely Indian system and this we must remember does not make any distinction between money-lending and banking. But efforts have been made by modern Indian writers to distinguish one from the other, in spite of the fact that most of the Provincial Banking Enquiry Committees to whom this task had been entrusted 'frankly admitted their inability to do so and could not very well

separate indigenous bankers from money-lenders or could draw no definite line of demarcation between them.' The result has been a complete failure. They have, in fact, succeeded in creating more of confusion. For instance, they say, "There is a great difference between a money-lender and an indigenous banker. A money-lender lends his own money, does not receive deposits, advances money either for productive or unproductive purposes... .. He usually combines agriculture, freight and other occupations with money-lending. The most fundamental difference, however, is that a money-lender finances consumption rather than production whereas an indigenous banker finances production rather than consumption. The indigenous banker deals with his own and borrowed money, receives deposits, finances trade and industry, confines only to banking business and deals in hundis". Next pointing out the difference between an indigenous banker and a modern joint stock bank, they say, "All indigenous bankers do not receive deposits... ..; the modern banks raise funds mainly by deposits. Unlike the modern banks, the indigenous bankers do not confine themselves to banking alone but usually combine other occupations with it. Again, unlike the modern banks, they do not confine mainly to advances for production purposes." How contradictory they are! At one place they seem to suggest that the indigenous bankers receive deposits, finance mostly productive needs and generally confine their business to banking only but at other place they seem to suggest that the indigenous bankers do not receive deposits or finance mostly productive needs or generally confine their business to banking only. It may be asked from them as to where are the differences they point between a money-lender and an indigenous banker. The Central Banking Enquiry Committee has remarked in the course of its report "we are aware that while there are money-lenders who receive deposits, there are certain classes of banking communities who, though they do not, as a class receive deposits, have been regarded by the public for all practical purposes as bankers." In fact, "for the public there is no difference between a banker and a money-lender." If we say like the

the proud Agarwal to the humble Kandu. For many centuries the bania tribe has borne a bad name for rapacity and meanness. 'Bania mare jan, thag mare anjan': The robber slays strangers, the bania his friends. 'Na bania mit, na beswa satr': A friendly bania is as common as a chaste courtesan. 'A bania goes in like a needle and comes out like a sword.' But he is not so bad as he is painted. The village money-lender is an indispensable element in rural life—an element that is often expensive and sometimes dangerous but always necessary. Should he withhold credit, as under the stress of circumstances he sometimes does, then widespread distress quickly follows³

Though in the above description the word 'bania' has been used as a synonym to money-lender, commonly it is one of the classes of money-lenders dealing in grain or provisions or keeping small general shops. They sell goods on credit and also lend money in small sums. They are low class Vaishyas. Their capital is small and position almost equal to the people with whom they deal.

Another class of money lenders is known as mahajan. In contrast to the bania, a mahajan's capital is huge and business on a very large scale. Like the bania, he may also be of any caste, but more often a money-lender belonging to one of the higher castes is called only a mahajan and not bania. A mahajan's position is much higher than that of the people with whom he deals, and generally he is held in high esteem by them. He is either a zamindar or does a better business than that of albania.

On the urban side, the money-lenders beside taking the above mentioned designations also take those of the sahu-kars, shroffs or sarrafs, and kothiwals.

A sahuکار is, in all characteristics, equivalent to a mahajan, though as compared with him, he is usually a financial magnate. A sahuکار carries on rural transactions as well, and these may take generally one of the two forms. Firstly, he may advance money to landlords on the security of a mortgage of their landed property. And secondly, he

³U. P. Banking Enquiry Committee Report.

may finance the village mahajan when he requires accommodation.

The shroff or sarraf is primarily a bullion dealer. Besides lending money, he also deals in hundis and sometimes receives small deposits too. All these functions may also be performed by wholesale grain, ghee, sugar, cloth and other dealers.

The kothiwal is usually a zamindar or business and industrial magnate performing the more important of banking functions. Sometimes he also lends to landlords—both small and big.

In addition to the above fixed or stationary money-lenders, there are also what may be known as itinerant peripatetic money-lenders. Their activities are mostly confined to villages though some of them may also be sometimes found in towns.

The most important of these is qistwala or qistia. In the western districts of U. P. he is known as rahtiwalā; in Oudh, ugalīwala; and in the eastern districts of U. P. as hundiwala or tharakkar. He lends on a system usually known as qist or ugalī meaning 'instalment.' A loan of Rs. 10 is generally realised in this case in 12 monthly instalments of Re. 1 each. Arrangements for making such advances may be made by persons residing in important towns through their representatives or by those wandering themselves. An illustration of the former is provided by the sahus of Moradabad of U. P. and of the latter by the Kabulis, the Harhīas, the Beoparis, etc. The Kabulis are the Pathans belonging to Afghanistan. They deal primarily in cloth and wander from one place to another selling the same on credit and realising the prices in instalments. Sometimes they also advance money. Harhīas are the usurers from Bihar. They deal in cattle also. In all other characteristics they are equivalent to Kabulis. The Beoparis are also like the Harhīas but belonging to U. P. mostly.

Then, there are a host of others. The Banjaras are the grain-dealers and carriers. Their money-lending activities are confined mostly to the submontane tracts. The Behwaris

are the butcher money-lenders. The Pheriwala is the name given to all pedlars who generally prefer to sell on credit principally to enable them to charge higher prices. The khandsali is a dealer in sugar who makes advances on condition of receiving canes or gur at a fixed forward price.

This is mostly about U. P. and Northern India. In other parts of the country there are similar money-lenders though called by different names. In Southern India and also Burma, there are Chettis. Among them the Punathukudi Chettis are small traders. "They travel about the country with small bags on their shoulders and may be likened to gipsies" Then, there are Nattukotai Chettis who are well-known for their riches. Their methods resemble those of the kothiwalas. In Sind are the Shikarpuri Multanis and in Gujerat the Bohras, etc., etc

Over and above the professional money-lenders mentioned so far, there are also amateur money-lenders. They belong to all classes, e.g., pensioners, both civil and military; temple priests; village officials, i.e., patwaris and schoolmasters; nai; chamar; faqirs, etc. Some of the widows also carry on this business. Then, there are the agriculturist money-lenders, the zamindar money-lenders and tenant money-lenders. The difference between these money-lenders and professional money-lenders is that while the former do not profess money-lending as their business the latter do so. The profit of the amateur money-lenders out of money-lending business is very insignificant. They depend for their livelihood on some other profession.

It has already been said that some, out of the above classes of money-lenders and specially the shroffs or sarrafs, the kothiwalas and the nattukotai chettis and others who resemble the kothiwalas, do perform also the other kinds of banking functions. Most of them do not, of course, encourage deposits from the public. Their hundi business is also not very important, as this document in India has always been used for remittance purposes, and this business as we shall see later on has now been usurped by the modern banks and postal department of the Government. But notwithstanding all this there are isolated individuals or firms

in various parts of the country which receive deposits and allow their customers to draw cheques on them. They have adopted the methods of the modern banks, so to say.

Method of their Business

The methods of their business are very cheap and simple. The establishment is neither costly nor imposing. There is, no doubt, a regular office, but maintained in the most ordinary style. The methods of accounts too are very simple though at the same time accurate and efficient. In the case of those who perform only money-lending business and that too on a very small scale, there may not be any office. Some of them may not maintain accounts too. There is no system of elaborate formalities to be gone through before an advance may be obtained and hence there is no question of any delay. These bankers do not also believe in advertisement. Rather, they maintain utmost secrecy with regard to their business. Whatever training is required, it is available from the old members of the family. The languages, scripts and numerals used by them vary from province to province, and sometimes in the same province and town. There are special codes also. In one of the Kathiawar codes as laid down by Dr. L. C. Jain in his book *Indigenous Banking in India*, Kits=one; Dhar=two; Udhan=three; Goth=four; Mui=five. Again, following special words for numerals are prevalent in our own provinces:—

Sang=1; Swan=2; Ekwai=3; Fonk=4; Budh=5; Dhink=6; Pank=7; Rakh=8; Nung=9; Mindhi=10.

Various Systems of Money-lending

There are various systems of money-lending followed by the money-lenders and indigenous bankers in this country. Of these the following, being the most common, may be mentioned.⁴

(1) *Promissory Note*. When the amount of the loan and the rate of interest to be charged on it is settled between the two parties, the borrower writes out a promissory note promising to pay on demand the principal and the interest

⁴L. C. Jain, *Indigenous Banking*.

which is mentioned. The money-lenders also require sureties for huge sums called *Zamins* to attest the pro-note. In case of the failure of the borrowers to do so, higher rates of interest are charged.

(2) *Rasid or Teezp.* When pro-notes are not used *rasids* or *teezs* acknowledging the loans are signed. There is also a mention of the agreed rate of interest in them.

(3) *Dastavez or Tamassuk.* This is written out on stamped Government papers. It contains various details of the loans. Usually there is a mention of a penal rate of interest in case of the non-payment of the amount of the loan on the due date.

(4) *Ticket Bahis.* These are stamped *bahis* on which the borrowers' signatures are pledged for the repayment of the loans taken by them. It is not customary to mention therein the conditions or the rates of interest, etc. Only verbal agreements are made with regard to these things.

(5) *Kist.* It is also known as *banaj*, *rehat* and *rehti*. A mention of its characteristics has already been made. Sometimes the first instalment is deducted at the time the loan is contracted. In recent times, consequent upon the denial of the receiving of money by the borrowers, there developed the practice of obtaining a thumb-impression and signature of the borrower on a separate account-book or a written contract.

(6) *Rujahi.* It is another system of *kist* wherein a man borrowing Rs. 30 gets Rs. 28 and pays the whole sum in one full month of 30 days paying Re. 1 each day.

(7) *Hatudhar or Dastgurda.* In this case, there is neither a written document nor a witness to be produced as an evidence of the loan. The credit is granted by word of mouth only on both sides and sometimes on oath.

(8) *Girvin.* This is the Hindustani word for pledge or pawning. It means lending of money against the pledge of gold and silver ornaments, etc. Usually a considerable margin is kept between the value of the property pledged and the amount of the loan granted. This system is very popular with Indian ladies and specially widows.

(9) *Rehan.* This is a mortgage of landed property or

houses. Herein a mortgage-deed called *Rehan-nama* is duly registered with the registrar of the district in which property is located. In this are mentioned the dates of payment of instalments of the loan, etc., etc. There are different kinds of mortgage and each one of them has a distinguishing feature. First of all, there may be a simple mortgage. In this case, the possession of the property remains with the borrower. Then, there may be an usufructuary mortgage, wherein the possession of the property is also made over to the creditor and he receives the profits therefrom as interest so long as the principal is not repaid. Often, the money-lender allows the borrower to use the property in lieu of the payment of rent. Sometimes there is a provision to the effect that the borrower shall not be able to redeem the mortgage, if he fails to repay the principal within a specified period. Thirdly, there may be a Patta Patawan mortgage wherein the possession of the property is given to the mortgagee for a fixed period at the end of which it reverts to the mortgagor free of all charges.

The above are the systems of cash loans. There are also kind loans. The following are very common :—

(1) An advance of grain for sowing or consumption purposes on condition of return of Sawaya ($1\frac{1}{4}$ times), or Dyodha ($1\frac{1}{2}$ times) or Doona (twice) at harvest time.

(2) A zamindar-cum-money-lender often advances by (seed) and money for *khawar* (consumption purposes) according to some settlement and in return when the harvest is reaped after recovering the original advances, shares the produce with the cultivator half and half.

There is also a system of mixed loans wherein the borrower takes cash as well as commodities in which the money-lender deals and his account is kept up-to-date by debiting it with the amounts of various transactions. Settlement is made at the time of harvest when the produce is sold.

Sometimes loans are granted on condition that the borrower sells the produce of the crops when ready to the lender at a stipulated price. This is very common with the money-lenders who also deal in the commodities which the

borrower produces. It has been generally observed that the price fixed under the circumstances is extraordinarily low and as a result the borrower suffers considerably.

Interest and other Charges

Interest charges vary from place to place and time to time. Taking the kind loans first, the rate of interest is often 25 per cent., or even 100 per cent. depending upon whether the system followed is that of sawaya, dyodha or doona respectively. These rates are, however, only for the period of the loan, which is approximately six months or less; hence the rates per annum are even higher than these.

For cash loans, they range from 8 to 12 per cent in case of good security and from 12 to 37½ per cent without security. Sometimes they are one anna per rupee per month, which is 6¼ per cent per month and 75 per cent per annum.

The Sahukars charge among themselves 9 per cent per annum only. This is called the Sahukari Byaj.

The interest charged is usually compound. There are many cases where the debt amounts to three, four or five times the original loan because of the compound interest charges.

Besides the simple and compound interest, money-lenders receive some extra payments according to the custom of the locality. On the country-side, it is not unusual to find the borrower rendering services free of charge to the lender and specially during ceremonial occasions. There is very often a dharamkhata (charity account) to which something is required to be contributed by the borrower at the time of the contraction of loan. Something is also deducted by way of likhai (writing charges) to be divided among the munim and the darwans of the money-lender. From amongst other charges heard of may be mentioned, nazrana thaili ki munh khulai, and dasturi. These are, however, or the wane.

But when recourse is made to a court of law, though it is not very common, the above rates of interest and other charges are not allowed. Nearly every province has se

amended the Usurious Loans Act (1918) as to make it incumbent upon it to re-open the account of a creditor with his debtor and bring down the rate of interest charged to a level specified in the amending Acts. But such a proceeding lay previously in the discretion of the court. It has, however, been made obligatory in recent years in most of the provinces. The change was introduced in Bengal in 1933, in Assam, Central Provinces, the Punjab and United Provinces in 1934, in North-West Frontier Province in 1935, in Madras in 1937, and in Bombay in 1938. In Bihar nothing has, however, been done in this direction so far. The Money-lenders Act III of 1938 of that province leaves action to the discretion of the court as before.

FUNCTIONS OF MONEY-LENDERS AND INDIGENOUS BANKERS

Taking only those first who only lend, it may be said that they provide funds both for production and consumption purposes. In certain cases they provide also the corn, seeds and cattle, etc. to agriculturists. They meet the need of all sorts, of people—rich and poor, agriculturists and non-agriculturists—whether they are able to offer any security or not. The rich borrow from them to purchase luxuries, the poor to purchase necessities, the agriculturists to carry on agricultural operations and the non-agriculturists to carry on trade, industry and commerce. They are thus indispensable in the economic life of the people whom they serve, and the people know it. They show a great regard for them. It has often been observed that the borrowers prefer the methods of indigenous money-lenders to those of the foreign bankers. They do not keep them waiting for their money till the time for its profitable use has passed. They do not press for repayment at due dates, if they know that such repayment is inconvenient. They do not conduct embarrassing inquiries into their clients' financial condition, for they know it. An estimate of their importance may be made by looking into the total indebtedness of the people to them in this country. Dr. Jain, writing in 1928 said, "It is very difficult to precise, but it may be hazarded that the total indebtedness to money-lenders in India amounts to between 800 and 900 crores of rupees." Since then, the

condition has much deteriorated and we may safely say that it cannot be less than Rs. 1,200 crores at present.⁵ This sum is far in excess of what are the combined resources of all the modern banks in this country.

Coming to those who, in addition to carrying on the operations of a money-lender on a larger scale, also receive deposits and/or deal in hundis, we may say that their activities are diverse and of varied nature. So far as the financing of agriculture, the primary industry of India, goes, it is done by them indirectly. They generally find it impracticable to establish direct relations with the peasants because, as we have already observed, they live mostly in urban areas. Hence, what they do is that they catch hold of the village money-lenders and traders. These receive accommodation from them and bring the crop produce in its stead. As far as the disposing of the crop by the cultivators is concerned, broadly speaking two methods are prevalent. Firstly, there are the small and uneducated cultivators, who usually sell their produce to the village trader who also happens to be a money-lender, and to whom they are generally indebted for advances made either at the time of sowing the crops or afterwards. The village money-lender pays his customers for the produce in cash but deducts, in part or in whole, the money lent to them. He, then, sells some of the purchased produce in the village for local consumption and the surplus to town trader (again a money-lender or a banker), and from whom he usually obtains accommodation. At this stage a considerable amount of general banking business, *e. g.*, buying and selling remittance, discounting hundis, and giving loans against stock-in-trade also takes place. Secondly there are numerous mandis or exchange marts—each patronised by a set of neighbouring villages—to which the

⁵ A change has come due to the rise in prices of agricultural goods during the present war period. There are some who say that a considerable part of the agricultural debt has been wiped off. But there are others who say that this has not been so. Whatever increased prices, agriculturists get, are spent up in the purchase of their other requirements. Besides, if there has been some gain, it has been only in the case of well-to-do tenants who were never in debt.

more enlightened producers or those who are not bound to money-lenders, as well as some village money-lending traders who buy crops from their customers, bring their commodities for sale. In these trading centres prices are determined by free interplay of the forces of demand and supply, which does not always happen in the villages. To these marts come a variety of buyers, the town traders, the agents of indigenous banking houses buying on their own account, or on behalf of customers, and representatives of exporting firms. Payments are usually made in cash, which necessitates large sums of money being brought from one trading centre to another.

Then, taking the financing of industry, it may be said that they do not take much interest in those carried on under the large-scale system of production. This is perhaps due to their ignorance of the methods which are alien to the country. But in recent years, they have been found taking interest in them. Some of the newly started industrial concerns owe their origin to them. Quite an appreciable number is being run under their management. In some important towns the practice has grown among them of making deposits with the mill industries. "The fact of the matter is that these mills, on account of their large and prosperous working, inspire confidence among money-lenders and bankers, who are willing to invest their money in the mills as fixed deposits. They are, however, renewable on the expiry of the period stipulated—usually two months. This affords an opportunity to the money-lender to withdraw his money and invest it more profitably."

The financing of cottage industries is, however, mainly in their hands. As a rule, the artisan has a very small amount of capital of his own. The money-lenders and indigenous bankers supply him with the raw material and generally make it obligatory upon him to sell the entire product to them at a price which is considerably lower than what it ought to be. Illustrations of the facts may be given from the practices prevalent in the important towns of the country.

It has already been observed that the agricultural products are brought to the market by the assistance of the

money-lenders and indigenous bankers. Besides, they help the distribution of other goods also. These people do not act only as commission agents and keep the goods on behalf of others by paying for them for the time being, but also enable the actual sellers and purchasers in transferring money from one place to another by issuing demand hundis or discounting them. Of course, they do not play any important part in the financing of external trade except in so far as the movement is concerned within the country itself, *i e.*, from the towns to the ports and *vice versa*.

They receive very little of deposits from the public. When they do it, it is mostly with a view to oblige friends. Inter-borrowing is very common. Hundi business too, as has already been noted by us, has gone to the background. But there are shroffs who even now undertake this business. They buy whatever hundis arise at a high rate of discount for ready money, and when they have not enough money to carry on this business they simply re-discount them with the modern banks. The Imperial Bank considers this business safe as the shroff's endorsement makes them doubly strong and as they take good care as to their nature there is no danger. Finally, some of them have begun performing other functions on the lines of the modern banks, but their number is very small.

DEFECT IN THE ORGANISATION OF MONEY-LENDERS AND INDIGENOUS BANKERS

The organisation of money-lenders and indigenous bankers suffers from very serious defects.

(1) The majority of them are conservative and continue antiquated methods of business. No doubt, there are some who have made improvements and receive deposits, issue cheques and render other services to their clients just as the modern banks do, but their number is very limited.

(2) They are jealous of each other and have no organisation of their own, worth the name. No doubt, there are some ancient and modern associations, but these do not have a considerable number of them as members, and hence cannot be claimed to be representatives. The ancient associations such as mahajans and unchayats, etc., hav

lost much of their force due to the establishment of the law courts. A great portion of their activities is concerned with religious and social matters affecting the members, and not anything useful. Of the modern associations those of Bombay, *viz.*, the Bombay Shroffs' Association, the Marwari Chamber of Commerce, the Commission Agents' Association and the Multani Bankers' Association may be mentioned. There are some in other parts of the country also. They render a valuable service in bringing the members together and binding them in their common interest. But the position is not very satisfactory. The number of their members being small, their representative character may be questioned.

(3) They have not developed banking habits of the people in the country. Neither do they manufacture credit. They have done nothing to encourage the use of credit instruments like cheques and bills of exchange. *Hundis* too which have been known to them for long play a small part in their finance of trade, the bulk of which is financed by cash.

(4) Their main business, *viz.*, money-lending is also attendant with many evils. A distinction is hardly made between what are known as productive and unproductive uses. The rates of interest charged are very high, and the dealings of some of them, specially of the money-lenders are often dishonest. In short, it is open to serious objections.

(5) Notwithstanding the petty money-lenders alone, even the largest indigenous bankers combine trading with banking. There are some who speculate in Government papers during the off-season. No doubt, in several other countries also the private bankers who do not subject themselves to any official regulations pursue an elementary form of banking business in addition to other and more lucrative forms of business. But its main defect is that their depositors stand to lose their money if they suffer on account of such activities. In India there is no such fear, as they do not usually have deposits. But the Reserve Bank of India as we shall see later on would not agree to their direct linking with it so long as they do not give up

this part of their business.

(6) Some of them, and it is specially true of many money-lenders, do not keep proper books of accounts. Audit is almost unknown to them. Under the circumstances, the central bank of the country cannot be expected to help them in any way.

(7) No statistical data is available regarding their business. This is needed with a view to find out the direction in which they should be improved.

(8) There is no regular contact between them and modern banking in the country so that two money markets exist side by side with different tendencies. It has often been observed that while there is a shortage of the loanable funds with the money-lenders and indigenous bankers and they charge very high rates of interest, there is an abundance of them with the modern banks and they discourage investment habits and dry up the channels through which credit flows to them.

SUGGESTIONS FOR REFORMING MONEY-LENDERS AND INDIGENOUS BANKERS

Various suggestions have been given from time to time for reforming money-lenders and indigenous bankers. Most of the Provincial Banking Enquiry Committees were in favour of the licensing of money-lending business. There was, however, a difference of opinion on the question whether it should be voluntary or compulsory. Those in favour of only voluntary licensing pointed out that (i) many of the money-lenders and indigenous bankers will strongly object to any restrictions on their business; (ii) owing to their strong position, they will be able to evade restrictions; and (iii) it will be difficult to provide for the compulsory licensing of non-professional money-lenders.

The advocates of compulsory licensing, on the other hand, said that (i) without a compulsory licensing system the objectionable practices of dishonest money-lenders could not be eliminated for the benefit of the masses; and (ii) such compulsory licensing had worked well in the cases of legal and medical professions and had not led to any legitimate complaints.

The terms suggested for the license were (i) the limitation of interest ; (ii) the keeping of accounts in a prescribed form and making audit compulsory ; (iii) the submission of his periodical accounts to each borrower ; (iv) the giving of receipts to all borrowers for repayment and keeping the counterfoils with the money-lenders ; and (v) fixing the period of rests to not less than a year for charging compound interest.

In return for the above restrictions the money-lender was to be given certain privileges. The most important of these were to be (i) the recovery of loans given by him against agricultural hundis or warehouse receipts by the procedure that is applied to the recovery of public demand ; (ii) the facility of receiving advances of money from the banks on the security of agricultural papers, of sending remittances through Imperial Bank and post-offices on the terms granted by them to joint stocks banks and co-operative societies respectively, and of opening current accounts with the post-offices withdrawable by cheques.

But there were committees including the Central, which were in favour of neither a compulsory nor voluntary licensing. Licensing was suggested for two purposes, viz, (i) that for lowering the rates of interest charged by the money-lenders, and (ii) that for checking the objectionable practices of some of them. These committees argued that the first object could be secured by the progress of mass education, the development of habits of thrift and saving among the people, and breaking up of the monopoly of the money-lenders. And as far as the security of the second object was concerned, they said that it required further legislation prohibiting money-lenders from resorting to objectionable practices under the threat of heavier penalties.

Since then a good deal has been done.⁶ The money-lender as the source of credit has been required to register himself and obtain a license in Bihar (1938), the Central Provinces (1936) and the Punjab (1938). The Bombay

⁶Vide 'Provincial Debt Legislation, Abhyankar and *The Relief of Agricultural Debt*, Strickland.

Money-lenders' Bill (1938), the Bengal Money-lenders' Bill (1938), and the U. P. Money-lenders' Bill (1939) also provide for registration. The suit of an unlicensed money-lender is required to be dismissed in Punjab, Bihar, Bengal and U. P., time for making good the defect is allowed in Bombay. The C. P. Act imposes a fine, which penalty is also to be imposed over and above non-suiting in Bengal and U. P. Further, in U. P. there is also a provision for the disqualification of the money-lender. The enforcement of registration being, however, not easy, in some provinces there is a provision for the cancellation of a license by the Collector if the holder is shown to be guilty of fraud or of infringing the major provisions of the law. The Punjab Act lays down that he must have offended against the Regulation of Accounts Act (I of 1930) three times before his license can be cancelled.

The accounts of a money-lender are regulated by law in almost all the provinces, the only exception being the newly-created provinces of Orissa and Sind. A form of account books is drawn up by the Governments, and he is directed to issue receipts for payments, to give to borrowers a copy of each transaction, and to send to every debtor a statement, annually or six-monthly, of the accounts, of the period. In Assam and Madras this statement is to be supplied only on the debtor's demand—some provinces permit the creditor to write it in the script and language which he ordinarily uses; others offer him a choice of several, but the debtor may on payment obtain it in the script in which he prefers. Only the Central Provinces have the simple rule (which alone protects the debtor) that the language must always be the court-language of the district. The entry of a fictitious amount, larger than the actual loan, in order to circumvent the limitation of interest-rates is punishable by fine in Assam, Bihar, Bombay and the United Provinces. In the Punjab, the suit may be dismissed.

In the above provinces and in Travancore state also a maximum rate of interest which may be decreed by a law court has been enacted; in many other states it already existed. With one exception, the maximum ranges

from 25 per cent (Bengal and North-West Frontier Province) to 12 (Bihar and Bombay) on unsecured loans and from 15 to 9 per cent on secured loans. The exception is Madras (IV of 1938), which after reducing interest to 5 per cent with retrospective effect on existing loans, limits the rate on all future loans to agriculturists to $6\frac{1}{4}$ per cent (simple interest). It is unlikely that peasants can borrow at this rate except from co-operative societies or from the treasury; the law, therefore, allows the Government to notify a higher rate. The mode of imposing the interest limit is to declare that the minima, laid down in the laws, shall be presumed by a court to be usurious. In the North-West Frontier Province and the United Provinces, it is added that certain other rates (15 per cent on unsecured loans in the North-West Frontier Province) shall not be deemed usurious. Such a provision is not easy to justify. The old Hindu rule of *damdupat* has also been embodied in debt legislation by Assam, Bengal, Central Provinces, Madras, the Punjab and United Provinces. The central idea is that the interest on a loan shall not exceed the principal, and this is good in so far as it leads creditors to sue within a reasonable term of years, instead of piling up the total at compound interest. The interpretation of the rule is, however, not easy, especially on a running account of many items extending over a long period, and the laws vary in their phraseology in consequence. Thus whereas Madras (IV of 1938) lays down that a debt is discharged when twice the principal loan has been repaid, Assam (IV of 1934) says that the interest decreed by a court is not to exceed the principal: a very different provision, and more liberal to the creditor who is suing on a recent balance of account. The Madras form is perhaps the most effective, but it involves the court in long researches into old accounts for which judicial officers may not always have time. Bihar (III of 1938) does not rely on *damdupat*, but forbids a court to grant more than three years interest.

Several provinces also protect the property of the borrower. Bengal and Bihar exempt one acre of land and Bengal (VII of 1936) the dwelling house; the United Provinces (XXVI of 1934) has a similar but less explicit provision. The Bombay Temporary Relief Act mentioned under

A(1), exempts land, house, crop and cattle. Bengal (VII of 1936) directs a Conciliation Board to reduce a debtor's liabilities to a total which he can pay off in twenty years. The United Provinces Act (XXVII of 1934) orders that instalments be granted for payment in fifteen years or less; and if a mortgage with possession is allowed to creditors, their debt is to be extinguished in twenty years, when the court shall eject the mortgagee and restore the land to the cultivator. The Punjab had long restricted the alienation of land by agriculturists to non-agriculturists under the Alienation of Land Act (XIII of 1900), but has now amended the law (Alienation of Land: Further Amendment Act, 1938) to prevent alienation to agriculturist money-lenders. The amendments may not succeed fully in their purpose, but will certainly protect the indebted peasant to some extent. A still more unusual Punjab law is the Restitution of Mortgaged Lands Act, 1938, which empowers a Collector to eject a mortgagee, who holds possession under a mortgage made prior to Act XIII of 1900, and restore the peasant to his land, on a moderate payment, if necessary. By Punjab Act II of 1936 a District Officer is further bound to limit to twenty years a mortgage of agricultural land, given in execution by order of a court.

These are only some of the Acts passed. There are still many whose mention has not been made here. In some cases molestation and intimidation of debtors has also been forbidden and this has really gone a good deal to check the activities of the Kabulis and others against whom repeated complaints had been made for the use of violence. It cannot, however, be claimed that there is nothing left now to be done. Some of these Acts suffer from serious defects and they shall have to be removed in due course of time. But this can be done only after full experience. In England and other Western countries where such laws had been framed long before, even now broad loop-holes are brought to light. The law has little force as against the dishonest. It merely enables an honest money-lender to offer *prima facie* evidence of the fact that he is honest.

Those of the indigenous bankers who perform other functions of banking than that of money-lending alone

can also be made to become more useful members of the financial organisation of the country by taking certain important steps. There is a need of their continuance. The joint stock banks, the Imperial Bank, and the co-operative institutions cannot be expected to supply the banking facilities to all parts of India, and replace them. There is an important activity awaiting development, *viz.*, bill broking and accepting and this can be successfully undertaken by them. We know that they have been dealing in hundis from times immemorial and their experience regarding them will prove very useful in the development of the bill market whose necessity to the Indian banking system has been so keenly felt for long.

The Central Banking Enquiry Committee in this connection showed the necessity of linking them with the Reserve Bank of India, and for this purpose it laid down certain conditions which must be fulfilled by them before being eligible for it. The Reserve Bank of India has been established, but nothing has been done so far to link them to it. The section 55 (1) of the Reserve Bank of India Act prescribed that "the Bank shall at the earliest practicable date and in any case within three years from the date on which this chapter comes into force (*i.e.*, on or before the 31st December, 1937), make to the Governor-General in Council a report, with proposals, if it thinks fit on the following matters, namely :—

(a) the extension of the provisions of this Act relating to scheduled banks to persons and firms, not being scheduled banks engaged in British India in the business of banking, and

(b) the improvement of the machinery for dealing with agricultural finance and methods for effecting a closer connection between agricultural enterprise and the operations of the bank.

Part (a) refers to indigenous bankers but to the extent they finance the movement of crops and also provide credit directly or indirectly to agriculturists, they are an agency for supplying agricultural finance, and thus the question of their improvement and the co-ordination of their activities with the Reserve Bank is also partly included in

part (b) of the terms and hence the two terms were interconnected.

The bank in fulfilment of the above requirement released what are known as a Preliminary Report and a Statutory Report in December, 1936 and 1937 respectively. The two reports may be regarded as complementary and covered much ground. As a step toward controlling the rates of interest and the money-lenders' methods of business, they suggested legislation for the regulation of the business of money-lending and some of the Acts whose provisions we have already discussed were based on the suggestions contained therein. Concrete proposals⁷ were also made to the representatives of indigenous bankers and others with a view to link them to the Reserve Bank of India. They were not new and were based on the recommendations of the Central Banking Enquiry Committee. Very briefly, they suggested that if the indigenous bankers were to come into practical relationship with it, they will have to formalise their methods of business on lines approximating to joint stock banks, and in particular, develop the deposit side of banking activities. From the replies received thereto, it may be concluded that they all disagreed with the suggestions regarding the taking of deposits and giving due publicity to accounts. There was, no doubt, agreement on various other points, *e g*, the maintenance of accounts in approved form, and giving up of speculative business. They were also not prepared to confine themselves to banking business only. They felt that in some cases the stoppage of a non-banking ancestral business would involve not only the closing up of a lucrative source of income, but might be a blow to the prestige of the indigenous bankers concerned in their locality. This seems to be truly speaking a correct view. It may also be said that there seems to be no valid ground for the insistence of the Reserve Bank of India on the indigenous banker's receiving deposits when they perform many of the other banking functions. We do not understand why should so much stress be laid out only on this function on the lines of the English bank-

⁷Please consult Appendix B in the end.

ing system. Can India not follow the system it has evolved after an experience of centuries? The indigenous bankers themselves are anxious to take a leading place as bankers in the life of the country, as important as they had in the past. The difficulty arises because of the different view taken by those who are the masters of the destiny of the country. They being alien cannot be impressed with what is indigenous, and must regard only their own methods and agencies useful. The attitude of the bank must change with regard to this question. It is, however, very necessary that the indigenous bankers too must change their methods or business with a change in the time, and attain a standard worthy of the membership of a central bank.

There is one more suggestion mentioned in the Statutory Report, and this as has also been the expectation of the bank may result in ultimately bringing the indigenous bankers in direct relationship with it 'without compelling them even in the least to modify the essential character of their business or to submit to unduly rigid restrictions'. We already know that they have been accustomed to the use of hundis for long. In case they take the trouble of augmenting the same, a bill market can be developed in this country. The bank has promised to extend its open market operations to hundis also in the same way as it does to Government securities, and this would surely bring at least the important ones in close touch with it. So far, the stamp duty on the instruments had been on a scale which made any augmentation in their use impossible, but since 1910, it has been reduced and now at least one of the impediments to it has been done away with. We shall take up this topic in greater detail elsewhere.

ADVANTAGES OF THE DIRECT RELATIONSHIP OF THE INDIGENOUS BANKERS WITH THE RESERVE BANK OF INDIA

The question is as to what are the advantages of the direct relationship of the indigenous bankers with the Reserve Bank of India. At one stage, it was suggested that they should have an access to the premier bank of the country only through the joint stock banks and the Imperial Bank of India. They maintain a list of the approved

indigenous bankers whose hundis they are always prepared to discount to a limited extent and it was thought that this was enough and these hundis should be allowed to be re-discounted with the bank if it was presented only through them. But there was put up a great opposition to this suggestion and it has now been abandoned. As was pointed out by Chunilal B. Mehta, President, Bombay Shroff Association, Bombay, in his letter dated 24th September, 1937 to Sir James Taylor, Kt. C. I. E., Governor, Reserve Bank of India, Calcutta, the commercial banks did not assist the indigenous bankers. On the contrary, they had competed with them and taken away their business, and, hence, they could not be accepted to welcome the suggestion of having an access to the bank only through them. The following are the advantages of such an access :—

(1) 'The history of the world since the last War has made it abundantly clear that if a country is to be financially sound and independent it must have a properly co-ordinated banking system which will embrace all the important banking activities of the country and co-ordinate them in a well-ordered whole under the general supervision and control of its central bank.' The indigenous bankers too perform very important banking activities and in the smaller country towns and in the villages, they are the only agencies performing these activities; the joint stock banks are either non-existent or play a very minor role in comparison with them. Even in important towns and ports where a substantial business is in the hands of the modern banks, they continue to carry on some valuable activities. Under the circumstances, it is necessary that they must also be linked with the Reserve Bank in the same way as the modern banks have been. This will result in the co-ordination of the activities in the two markets which exist in the country, viz., indigenous money-market and the modern money-market. It will also result in the raising of the standard and improving of the activities of the indigenous bankers

(2) The indigenous bankers have in recent years lost whatever deposits they had in past years. This has been due to many causes, the most important of them

being, as pointed out by Chunilal B. Mehta in his letter already referred to, the offer of high rates of interest by the joint stock banks and the Government. In old times, they received deposits even without any interest. Whatever might have been the reasons in recent times for the weakening of the old system, the linking with the Reserve Bank is expected to encourage more deposits being drawn towards them. And hence, it is now clear that the receiving of deposits should not be made a condition precedent to their linking with the Reserve Bank but may be expected to follow as a result.

(3) It is expected that as a result of the proposed establishment of their direct relationship with the bank, the banking business of the indigenous bankers will increase and then they will be in a position to gradually shed down their non-banking business. Hence, it may be said that this should also not be made a condition precedent to their linking but be expected to follow as a result.

(4) Another advantage of the proposed linking will be that the indigenous bankers shall become eligible for obtaining loans and advances and discount facilities from the Reserve Bank. It may be pointed out here that any restriction of it, e.g., limitation to only emergency periods as proposed by the bank, will destroy the prime benefit of the direct relationship. There cannot surely be any objection to the gradual stiffening of its attitude with the improvement of the position of the indigenous bankers which must follow as a result of the linking.

(5) Though the indigenous bankers have taken a serious objection to the publicity of their accounts, they are willing to supply the particulars wanted by the Reserve Bank of India. These can be consolidated and published, thus giving an index of the country's financial position from time to time.

(6) Their direct relationship with the bank will enable them to obtain better remittance facilities. At present also some of the indigenous bankers, who have fulfilled certain prescribed conditions and are included in the

approved list of the Reserve Bank are allowed the same remittance facilities as the non-scheduled banks fulfilling similar conditions and included in the similar list.

RELATIONSHIP OF THE INDIGENOUS BANKERS WITH THE IMPERIAL BANK AND OTHER COMMERCIAL BANKS

The relationship of the indigenous bankers with the Imperial Bank and other commercial banks is not always very cordial. The latter maintain an approved list of the former, and confine their dealings with only such of them as are mentioned therein. The Bengal Committee stated that some branches of the Imperial Bank showed a lack of consideration even to old, reliable and substantial firms. Complaints have so often been made of the unfriendly treatment of the managers of the Imperial Bank and other commercial banks with the indigenous bankers. This may be attributed to their being in many cases non-Indians and often ignorant of the language spoken by the people. Even Indian managers have not been able to take as much interest in them as they ought to have done. The cause of this also is not far to seek. They, being, often 'moved from branch to branch, cannot obtain that local knowledge and personal touch which are very necessary for an adequate understanding of the needs and financial standing of their customers.' This is really a very serious defect of Indian banking system and has resulted in the segregation of the two important credit agencies whose co-ordination would be of the utmost benefit for trade and industry of the country.

Coming to those of the indigenous bankers whose names appear in their approved lists it may be said that they obtain cash credits from them on the basis of a promissory-note which is usually a two-named paper—in some cases one of the names being that of a merchant also. They discount their hundis with them. These are purchased by the indigenous bankers from the merchants for ready money. But in the majority of the cases, the accommodation is sought occasionally and only during the busy season when there is a shortage of funds and inter-borrow-

ing cannot be resorted to. It may be added that this can in no case exceed the limit prescribed against the name of the particular party in the approved list. This is determined as a result of inquiries into its financial position. So from all this it is obvious that there is no special advantage to the indigenous bankers from the fact of their being included in the list of the Imperial Bank and other commercial banks. They are treated just like ordinary customers. The cheques drawn on and crossed to them are not accepted by these banks.

In conclusion, it may be said that the position is not at all satisfactory, and efforts must be made by all the parties concerned to improve it. In this connection the feasibility of their forming a partnership on the German 'Kommandit' system may also be given due consideration. Under this system, a bank instead of opening a branch would arrange with a banker to supply him with funds to an agreed amount over and above his resources and local deposits, to divide profits in a pre-arranged manner, but in case of loss to hold him liable for the whole or a part of the loss. The lending bank while retaining the advantage of limited liability would enlist the support of the banker's local knowledge and connection. But this and other things can be made possible only by the improvement of the methods of working of the indigenous bankers themselves and their forming into strong and vociferous organisation which may put forward their claims to occupy the place in the Indian banking system to which they are entitled by their importance. In this way alone, they will be able to draw the sympathies of the public, the state, the Reserve Bank of India and the Imperial Bank and other commercial banks.

TEST QUESTIONS

1. What do you understand by the terms 'Indigenous Banking' and 'Indigenous Bankers'? Can you differentiate between a money-lender and an indigenous banker? Give a suitable definition of the term 'Indigenous Banker'.

2. Give a short description of the various kinds of money-lenders usually met with in rural and urban areas. Which

of them do perform other banking activities than that of lending money?

3. Write a short note on the methods, systems and charges of the money-lenders and indigenous bankers, explaining the various terms used in this connection.

4. Describe in brief the functions of money-lenders and indigenous bankers and show their importance to the people.

5. From what serious defects do money-lenders and indigenous bankers suffer? Explain them as clearly as you can.

6. What arguments were advanced by the various Banking Enquiry Committees with regard to the licensing of money-lenders? Point out different views as clearly as you can.

7. Give a short description of the laws passed in various provinces with a view to regulate money-lenders and their business and bring about the tendencies of the legislation in this connection.

8. Give your suggestions for the improvement of the business of the money-lenders and indigenous bankers. What advantages do you think will accrue by their being linked with the Reserve Bank of India?

9. Comment on the line adopted by the Reserve Bank of India in connection with the linking of the indigenous bankers with it. What should in your opinion be the attitude of the Bank?

10. Write a short note on the relationship of the money-lenders and indigenous bankers with the Imperial Bank of India and other commercial banks. Give your suggestions for its improvement.

CHAPTER XIV

AGRICULTURAL FINANCE

The problem of agricultural finance deserves special consideration, not only because of the importance of the agricultural industry to this country but also because of its special difficulties. There are certain important differences between agriculture and other productive industries and these lie at the root of agricultural finance. First of all, the unit of production in agriculture being one man's concern, the credit available for it is limited to the resources of the individual or his family. The modern method of raising credit by subscription through the mechanism of joint stock enterprise is not accessible to it. The industrialist, truly speaking, capitalises the future, or raises money on estimated earning power. The agriculturist, on the other hand, cannot do it. There is no commercial measure of his expectations in the eyes of the ordinary investor. Under the circumstances, the only alternative left to him is to raise money by credit. Secondly, the apparatus of commercial banking is not available to him. His principal need is of fixed capital to finance the expansion or improvement of his farm, and this involves long-term credit as it cannot possibly be repaid from the proceeds of a single crop or even of several crops. Land and other forms of real property being the securities which can be offered for it, commercial banks do not accept them. They have to preserve the liquidity of their assets which is not possible under this form of investment. And finally, agriculture can hardly be described here to be profitable. In the words of the Royal Commission on Agriculture it is more a mode of living than a profitable occupation. This involves further complications, and makes the repayment of debts absolutely impossible. To quote the Royal Commission again, 'the agriculturists are born in debt, live in debt and die in debt passing on the burden to those who follow them.' The total debt of the peasantry as has already

been said, cannot be less than Rs. 1,200 crores in any case at present¹ and there is a question of its repayment also. Broadly speaking, the credit needs of the agriculturists can be classified into (a) short-term, (b) intermediate, and (c) long-term. We shall now examine their problems and methods of solution.

(a) SHORT-TERM CREDIT NEEDS

Short-term credit needs of the agriculturists in India include all that they require for incurring current expenses of cultivation such as the cost of seeds, cost of labour, maintenance of their family during the period they harvest the crop and market it, as also other current expenses in the form of payments of land revenue, rent and interest on short-term capital. Normally assuming an economic holder, the cultivator expects to repay it at the end of the harvest when he receives the full value of the crop. This takes about nine months. There are some writers who include in this the expenses of marketing and movement of crops also. But it will serve the marketing interests of the agriculturists in a more effective manner, if it can be available for a longer period, say not exceeding three years, in which case it becomes an intermediate credit. Here, in this country, the bulk of the agricultural produce finds its market internally. In the majority of cases, the cultivator is forced to sell the whole produce at an unfavourable price, because of his poverty and inability to hold on for better prices. If he is supplied with finance, he may wait and not dispose of the stuff all at the same time and thus depress prices.

We may examine how the existing credit agencies finance the short-term needs of the agriculturists. In this connection, however, it may be said that the various credit agencies financing the agriculturists here do not usually make distinction between different needs. There are, of course, certain exceptions, which we shall discuss in due course.

¹It is said that some of the debt has been paid up during war period.

Reserve Bank of India

Since 1935, there is first of all the Reserve Bank of India. It has been authorised to finance agriculture in the following ways :—

(a) Loans or advances against Government papers or approved debentures of recognised land mortgage banks, which are declared trustee securities and which are readily marketable for ninety days to provincial co-operative banks and central land mortgage banks declared to be provincial co-operative banks and through them to co-operative central banks and primary land mortgage banks.

(b) Advances to provincial co-operative banks for ninety days against promissory notes of central co-operative banks and drawn for financing seasonal agricultural operations, or re-discount of such promissory notes maturing within nine months.

(c) Loans and advances not exceeding ninety days to provincial co-operative banks against promissory notes of approved co-operative marketing or warehousing societies endorsed by provincial co-operative banks and drawn for the marketing of crops or re-discount of such promissory notes maturing within nine months, or loans and advances on the promissory notes of provincial co-operative banks supported by warehouse receipts or pledge of goods against which a cash credit or overdraft has been granted by the provincial co-operative bank to marketing or warehousing societies.

Loans and advances required to be repaid within ninety days cannot help actual agricultural operations in any large measure. They may be used by the provincial co-operative banks or central land mortgage banks declared to be provincial co-operative banks only for meeting temporary shortage of their own funds provided they are sure of being replenished within this period. From this it is obvious that they cannot look to the Reserve Bank for the supply of normal agricultural credit. On the contrary, they may expect help only in cases of emergency. But there is also a provision for the re-discounting of the promissory notes of central co-operative banks and drawn for financing seasonal agricultural operations or of the approved co-opera-

tive marketing or warehousing societies, and in both cases maturing within nine months by the provincial co-operative banks. This is no doubt a bit helpful, though as far as the promissory notes of the co-operative marketing or warehousing societies are concerned they cannot arise in any large number because, as we know, there are very few co-operative marketing or warehousing societies in this country. From all this it is clear that the Reserve Bank recognises only provincial banks and not central banks for giving accommodation. We know that the agriculturists obtain credit from primary societies which look to central banks. As the Reserve Bank grants credit only to the provincial banks, the central banks, must obtain funds from them. This is really a very round about process and hence it is being suggested that the Reserve Bank should deal directly with such central banks as conform to a particular standard.

Imperial Bank of India and other Commercial Banks

Then, there are the Imperial Bank of India and other commercial banks. The former provides the provincial banks and central banks with cash credits and overdrafts on the security of the promissory notes of the central banks in the former and primary societies in the latter case. It has been reducing such advances in recent years, as the promissory notes being backed by land, are not regarded to be a good form of security. Again, it finances agriculture to some extent through the indigenous bankers who sometimes discount their hundis with it or obtain advances on the pledge of the produce. In the term other commercial banks are included the joint stock banks of the country. They carry on almost the same business as the Imperial Bank. Some of them also make advances to land-lords on the security of their landed property.

Credit Co-operative Societies

This brings us to credit co-operative societies. They originated in their present form for the first time in Germany in 1849. Fredrick William Raiffeisen and Fritz Hermann Schulze Delitzsch were the founders of the two

systems of co-operative credit now in vogue. They are known as Raiffeisen system and Schulze Delitzsch system respectively. In the former case, a number of farmers residing in the same neighbourhood or locality combine together on a voluntary basis and form a society for the purposes of mutual help. Liability of each member is limited. The society obtains funds from deposits, entrance fees and sometimes contribution of capital from the members, and borrowings, and these are advanced to members according to their means and requirements. Their management is mostly honorary, except the clerical staff which is on paid salary. By common consent the more intelligent from amongst the members are allowed to carry on the chief executive and superintending work. In the case of Schulze Delitzsch societies, a number of artisans residing in a town and working on their own account combine together and form the society. They raise a capital of guarantee by obliging each member to take up one share and one only, which is of large value. This sum is received in instalments spread over a convenient period, the object being to commit every member to a long course of saving. It also raises money by deposits and borrowings, and the amount of these is usually large, as they get it on the basis of their actual capital, and unlimited liability of members—no doubt in some cases the liability is limited also. The funds of the society are advanced as loan to members. The management receives remuneration and the profits are either divided or accumulated as reserves. In short, the characteristics of the two types of societies may be given on comparative basis as below :—

Raiffeisen Society

1. Limited area of operation.
2. Lack of share capital.
In case however, it is decided to have a share capital, it is very small.
3. Unlimited liability.

Schulze-Delitzsch

1. Wide area of operation.
2. Existence of capital.
3. In some cases limited liability.

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|--|---|
| 4. Loans are not issued to those who are not members | 4. Loans may be issued to non-members also. |
| 5. Loans are given mostly for productive purposes. | 5. Loans may be given for unproductive purposes also. |
| 6. Indivisibility of profits. | 6. Divisibility of profits. |
| 7. Management honorary. | 7. Management paid. |

History of Co-operation in India. Co-operation was officially set up in India in 1904, though attempts had been made in earlier years also. The first suggestion in this connection came from Sir William Wedderburn and Justice Ranade. This was turned down by the Secretary of State in spite of its acceptance by the Government of India. Next, Sir Frederick Nicholson submitted his "Report on Land and Agricultural Banks" to the Government of Madras in 1892 and recommended the establishment of the Raiffeisen type of societies. But this was also not brought into action. Later, Mr. Dupernex of the United Provinces Civil Service made attempts and these bore some fruits also as certain societies were established in the United Provinces, Bengal and the Punjab. Finally, in 1901, Lord Curzon's Government appointed a committee and its recommendations resulted in the enactment of the Co-operative Credit Societies Act of 1904.

This Act made provisions for the formation of credit societies only. Special emphasis was laid on rural rather than on urban credit societies. According to them, any ten persons from the same village or town or of the same tribe or caste could apply to form themselves into a co-operative credit society. In case, four-fifths of the members were agriculturists this was known as rural credit society, otherwise it was urban. The former was to be modelled on the Raiffeisen type and the latter on the Schulze Delitzsch. The power of compulsory inspection, audit and dissolution was vested in the Government.

The progress of the movement was remarkable and it was soon found to outgrow the scope of the 1904 Act. Hence, another Act was passed in 1912. It remedied the defects of the Act of 1904 and provided for the registration

of societies for purposes other than credit also. It substituted a scientific classification of societies based on the nature of the liability for the arbitrary one, viz, rural and urban. Finally, it recognized the central and provincial co-operative banks as well, and thus made provision for the building up of a powerful structure from the bottom to the top. It may be remarked that in spite of the removal of the limitations on the formation of non-credit co-operative societies by the Act of 1912, the prepondering element in Indian co-operation is still credit.

In 1914, the Maclagan Committee on Co-operation was appointed. It submitted its report next year. This led to the re-organisation and overhauling of the administration of co-operative societies. Those inefficient were eliminated. Punctuality in repayment was insisted upon and the non-official share began to increase.

The reforms of 1919 made co-operation a transferred provincial subject and the ministers in charge of it evinced a keen interest and immediately a number of new societies were formed all over the country. Various provincial committees have also been appointed since then, and they have brought the whole question to the forefront. The Statutory Report of the Reserve Bank of India also throws a good deal of light on the present movement and gives valuable suggestions for its re-organisation.

Present Position of the Credit Co-operative Movement in the Country.—The credit co-operative movement in India embraces (a) Primary credit co-operative societies, (b) Central co-operative banks, and (c) Provincial co-operative banks, at present. There is also the possibility of an Apex All-India Co-operative Bank, though it has not been started so far.

Primary credit co-operative societies are both rural and urban. Their number is approximately 1½ lakh and 18,000 respectively. The funds of a rural credit co-operative society are raised from entrance fees, share capital, deposits or loans from non-members, loans from central and provincial banks and Government, and the reserve fund. The aggregate amount is by no means negligible. It amounted to Rs. 121,14,32,000 at the end of 1912-13. The respective

figures are interesting :—

Share capital	...	Rs. 15,70,79,000
Reserve and other funds	..	Rs. 19,92,23,000
Deposits	...	Rs. - 78,45,39,000
Loans and Borrowings of land		
Mortgage Banks	...	Rs. 7,05,91,000
Total working capital	...	Rs. 121,14,32,000

They show that these institutions work with about Rs 56 crores of their own capital (including members' deposits also) as against their borrowed capital of about Rs. 65 crores. This is 17 per cent and has been steadily increasing.

Central co-operative banks are mostly located in the district headquarters. Their number is approximately 600. The functions of these banks is not only to supply the required capital to the primary societies but also to make the surplus resources of some societies available for other societies suffering from a deficiency of funds and to provide proper guidance and inspection over them. They are formed of primary societies and individual members as well and draw funds from (a) share capital, (b) reserve, (c) deposits, and (d) loans.

Provincial co-operative banks are found at present in India in all the major provinces and some of the states. In a large majority of them, the constitution is a mixed one, that is, both in the general body of the banks and in the directorate, there are individual shareholders as well as representatives of co-operative societies and central banks. Their working capital is derived from (a) shares, (b) reserve and other funds, (c) deposits and loans from individuals, societies, provincial and central banks, and Government.

Its progress has not been uniform in all the provinces. Bengal, the Punjab and Madras have the largest number of societies, while the other major provinces like Bombay, Bihar, the United Provinces, the Central Provinces and Assam are backward. The total number of members of primary societies stood in 1943 at 69.12 lakhs. Taking the normal family at a little under 5, it is clear that about 3½ crores of the people of India are being served by this move-

ment. In fact, there is no other agency in the country which affects so many people.

The Main Defects of the Movement. The success or otherwise of a credit co-operative society depends upon the promptness of repayment of loans by members. These are only short-term and must be repaid as soon as the harvest is reaped and the produce is sold. But this is not the case in India. Here, the overdue loans in agricultural societies amounted to Rs. 10.41 lakhs in 1940-41. This is 34 per cent of the aggregate working capital. Taking the percentage of the total advances made to individuals which amounted to Rs. 22.50 it was 46.

Most of the members of these societies do not understand the aims and objects of the movement. They are quite ignorant of the liabilities which the membership imposes and the rights it confers. They have not learnt from it the lesson of thrift and prudence. Besides, a co-operative society has also got to improve matters in spheres other than finance, e.g., better living, better farming, marketing, education, etc.

There are certain defects in the working of the central and provincial banks as well. In recent years, in the cases of central banks, the number of the societies affiliated to them has very much increased. The Statutory Report of the Reserve Bank mentions the case of one of them which dealt with as many as 680 societies. 'Where such large expansion has taken place, the work has become unwieldy and the co-operative character of the bank tends to become slender.' Neither the central banks nor the provincial banks have done their duty towards the primary societies. They have so far confined themselves only to their financing. Their duty is also to interest themselves in all activities calculated to tone up, consolidate and expand the movement. Besides, their own position is not very sound. In many cases, their resources are not so fluid as they ought to be. Then, they do not maintain sufficient margin between their borrowing and lending rates with a view not only to meet expenses but also to build up nice reserves.

Suggestions for Improvement. Credit co-operative societies should take up to the financing of only the short-term

needs of the agriculturists. At the most they may extend their activities to the financing of the intermediate term 'needs' as well. They should, on no account, take up to the financing of the long-term needs also. On the receipt of an application for a loan by a credit co-operative society, the members of the executive must find out the purpose or purposes for which it is required. 'Further, it goes without saying that if the co-operative societies are to be worthy of their name and not to be mere substitutes for the money-lender, they must see that the member borrows as far as possible for productive purposes and that loans for other purposes which though not strictly productive are absolutely necessary, are reduced to a minimum'. Another thing, which is perhaps of the utmost importance is to take into consideration his repaying capacity. One of the most important functions of a credit co-operative society is also to see that the members do not live beyond their means. Truly speaking, they have in the past violated this principle, and hence the accumulation of overdues. In fact, it is not of so much importance as to what is the object of the loan as is the fact whether the borrower shall be able to repay it out of the harvest and in certain cases within a period not exceeding three years in any case.

Next, as has been suggested in the Preliminary and Statutory Reports of the Reserve Bank the question of present overdues must also be taken up. It is no use to 'let the things slide' and continue granting extensions. 'Where the question of overdues has become serious the co-operative movement has ceased to function as an agency for the supply of agricultural credit and many who are nominally members of co-operative societies are being driven to have recourse to money-lenders. The overdues choke the flow of credit and must be tackled in a practical manner without delay.' They should be brought down by writing off the losses to an amount whose repayment may become possible within a reasonable period, say twenty years, and handed over to a land mortgage bank—an institution meant for the supply of long-term needs and whose study we shall make later on. In cases, the societies are not in a position to cover the losses, it must be decided

as to what agency can best bear them. A bolder policy always pays in the long run. Something must be done to face the facts which are inevitable.

These societies must in future work with adequate margins between the borrowing and lending rates so that they may be able to build up large reserve funds. The difficulty in the writing off the losses, from out of the present overdues, which cannot be repaid by the members even in easy instalments, is due to the fact that in past years, they did not work with sufficient margin and hence have failed to build up reserves which could have been utilised for this purpose. This does not in any way suggest that encouragement should be given for the accumulation of overdues in future also. It is only by way of an example. There can be thousands of ways for their utilization. In fact, this is one of the methods of strengthening the position of the societies.

Finally, the object of a society being to bring about an all round development of its members, it must endeavour to deal with the whole life of the cultivator. In fact, the members must be made to understand the true significance of co-operation. It is not only with a view to supply them with credit that the principle has been introduced, its object is far wide and can be fulfilled only when the villages begin to lead a better life from all points of view. Their income should be increased, and farming must be made a lucrative occupation. Truly speaking, the problem of rural finance cannot be solved without it. As one of the writers observes, 'unless we bring about a rapid improvement in the agricultural production which can assure to an average cultivator, at the end of an year's toil, a level of receipts which exceeds the total level of outlay during the year and leaves a margin which enables him to lead a reasonably satisfactory life, we cannot be said to have achieved a permanent solution of the problem of agricultural finance.'

The central and provincial banks also need reform. In cases where the number of societies affiliated to a central bank has increased very much, a provision must be made for their grouping under taluqa unions. This will facilitate the supervision and control. Both the central banks and

provincial banks must also re-organise themselves on strictly banking lines. They must above all keep their resources fluid. As in the case of primary societies, there is the necessity in their case also, of maintaining a sufficient margin between their borrowing and lending rates. The present practice of carrying bad debts from year to year should as far as possible be avoided, and this can be done only by increasing their gross earnings. Finally, there is a need of the establishment of a closer contact between central banks and commercial banks. The former can make use of the latter for the investment of their surplus funds and obtaining from them credit on Government papers or otherwise. The latter can on their part utilise the former for the collections of their bills in places where they have got no offices of their own. Such mutual dealings will result in benefits to both.

Remittance Facilities Given by the Reserve Bank to Co-operative Societies and Banks. The Reserve Bank of India, under its new scheme of Remittances in India and Burma introduced on October 1, 1940, charges the following concession rates from co-operative societies and banks :—

Upto Rs. 5,000		Over Rs. 5,000	
Rate	Minimum	Rate	Minimum
Per cent.	Charge	Per cent.	Charge.
	Rs. a. ps.		Rs. as. ps.
1/16	0 4 0	1/32	3 2 0

Money-lenders and Indigenous Bankers

We have already looked to the part that is being played by the money-lenders and indigenous bankers in the finance of agriculture. This must continue for a very long time to be so because of their simple methods of business, personal touch with the borrowers, local knowledge and experience. They had, of course, been hit very hard in certain cases due to the general economic depression of the thirties, the protection given to the agriculturist borrowers, the growth of co-operative societies, the delay in the matter of awarding decrees, and the suspicion against the questionable practices of a few of them. But steps have recently been taken to improve them and there

is every possibility of their becoming more useful in near future. No programme for the solution of the problem of agricultural finance and their improvement can be successful without the conciliation of the present debts of the agriculturists and its repayment. Five provinces *viz.*, Assam, Bengal, Central Provinces, Madras and the Punjab have already passed Debt Conciliation Acts, which provide for the setting up of the Debt Conciliation Boards by their respective provincial Governments. Their object is to attempt an amicable settlement of the outstanding dues by a voluntary agreement between the debtors and the creditors. Any debtor or creditor is allowed to apply to the Board for relief according to provisions of Debt Conciliation Acts. On receipt of the application, the board requires the creditors and the debtors to submit their total claims on the one hand and the total assets on the other. The claims are also required to be substantiated by documents. When the information has been received, the board proceeds to bring about a settlement of the dues of the debtor with his creditors. In case of an amicable settlement, a scheme for the payment of the decretal amounts in instalments not exceeding 20 or 25 in number is drawn up. To provide inducement to the creditors to join in the scheme, certain disabilities have been imposed on them if they refuse to accept an offer held to be reasonable by the Conciliation Board. In such cases, the board issues a certificate to the debtor in respect of such debts, and the courts of law are authorised not to allow costs and to award interest at a rate not higher than 6 per cent in any subsequent legal proceedings brought forward by the creditor for its recovery. Creditors accepting the amicable settlement at the hands of the conciliation boards are given a priority of recovery of their settled amounts. The inducements for joining in a settlement and the disabilities resulting from a refusal to accept are not the same in every province. Besides, legal practitioners are allowed to appear before the Boards in some provinces like the Punjab, while C. P., Assam, Madras and Bengal exclude them. Again, C. P., Assam and Bengal provide that in case the debtors fail to pay the instalments, the amounts due may be recovered through the agency of the Land Revenue Department. The

scheme of debt conciliation can, however, become more successful if accompanied by immediate payment. This as we shall see later on can only be made possible by the establishment of the land mortgage banks. The figures of debt conciliation in various provinces go to prove that the scheme has been very popular.

In certain cases, the debts have been compulsorily reduced under the provisions of the Agricultural Debtors' Relief Acts in the light of the fall of prices of agricultural produce.

The provisions of simple Rural Insolvency Act should be applied most reasonably in the case of those debtors who hold uneconomic pieces of land and whose assets and repaying capacity do not justify the conclusion that they would be in a position to repay their debts even if they are scaled down.

After the conciliation and scaling down of the present-day agricultural indebtedness to the money-lenders and indigenous bankers and its payment or cancellation in deserving cases and regulation of their methods of business, they can be made to play an important part in the agricultural finance. They cannot be regarded as being in a position of combining the three functions such as provision of short-term, intermediate and long-term finance, which belong by their very nature to different specialised institutions. The utmost they may do is to combine the first two. Besides, provisions should be made to safeguard against the cultivators falling into indebtedness again, and this can be made possible only by reducing the chances of granting them unlimited loans by the money-lenders and indigenous bankers. The U. P. Money-lenders' Bill, 1939, provides that at any time in a single year no creditor can attach and sell more than one-fourth of the crop of an agricultural debtor, and the creditor in question cannot attach such one-fourth of the crop for a longer period than four years since the date of advance of the loan. It means a limitation on the lender's loaning power to only four times the value of the standing crop, on the security of the crops. On the basis of the suggestions of the Calvert Committee, the approved money-lenders and.

indigenous bankers may also be given a prior claim on the crop of the debtor reserved as security against their advances.

(b) INTERMEDIATE CREDIT NEEDS

Apart from help for meeting the expenses of cultivation, a cultivator requires intermediate credit facilities for purchasing cattle or bringing about usual recurring improvements in land. As has already been suggested, the finances required for better and profitable marketing of crops may also be included in it. The amount borrowed for these purposes cannot be expected to be repaid within a single year, and must necessarily be spread over a comparatively longer period, but in no case exceeding three and at the most five years. The main security which a cultivator offers for advances of this character is his movable wealth in the form of ornaments or existing cattle and his annual crop.

Existing Financing Agencies for Intermediate Credit Needs and Suggestions for their Improvement

Most of the agencies financing short-term needs take up to the financing of the intermediate credit needs as well. Taking the marketing finance² first, it may be said that it begins from the time the produce is ready on the threshing floor. In certain cases, it begins earlier, *e.g.*, when the cultivator takes an advance on the understanding that he will sell his produce to the creditor who is, as we already know, either the village money-lender-cum-trader or some agent of the petty indigenous bankers. Neither of these, nor the cultivator is in a position to hold the stock on for better prices, and it finds its way to the big indigenous banker in the town. He is either a trade or commission agent, and ultimately the burden of financing the purchase falls upon him. If he has already made an advance to the party from whom he buys, he makes only an entry in his books. In other cases, he has to pay in cash, no doubt for the stock he holds on behalf of others in the capacity of a commission agent, he gets a part or the whole

² U. P. Banking Enquiry Committee Report.

in advance ; usually he gets a part and not the whole. Now, he wants accommodation from others, and it is available in the following ways :

(1) *Advances from Other Indigenous Bankers or Imperial Bank and Joint Stock Banks.* The amount and nature of these depend upon his good-will. In some cases he writes a promissory note, in others it is on the basis of a muddati hundi, in still others a current account is opened in his favour. If the advance is obtained on the basis of a muddati hundi from a fellow indigenous banker, this hundi is discounted with a commercial bank.

(2) *Advances for Storage.* He has produce stored in godowns which are transferred to the lender. If this financier is a fellow indigenous banker, he is content with the key. But in case it is Imperial Bank or a commercial bank, the bank puts on its own lock and signboard.

(3) *Funds in Connection With the Movement of Goods.* If he sells locally, the price is paid to him in cash, which may be done immediately or after some time depending upon the custom of the market. But if the goods are to be sent out, he receives payment either directly or more commonly draws a darshani hundi which may again be clean or supported by a railway receipt. In the case of a clean hundi, the railway receipt is sent directly to the consignee, and is made out in his name. In the case of a hundi supported by a railway receipt, however, it is handed over to a bank, and is made out in the name of the consigner who endorses it in favour of the bank which also purchases the hundi.

From the above description, it is clear that there are certain defects in this system which must be remedied. First of all, the cultivator is not in a position to hold the stock for better prices. Co-operative societies can help him by making advances and taking possession of the stock which they may sell gradually as the demand arises. This will enable the agriculturists not only to obtain better prices but also to be relieved of the various inconveniences of marketing. Secondly, there are storage difficulties. The peasant keeps his stock in earthen pots, in sacks, in enclosures made of matting, mud and wickerwork, or in under-

ground pits. In the market also, we have got these things differing only in size but not in kind. Hence, there is a good deal of loss from insects or rats, or underground damp. Improved methods cannot be adopted, due to heavy initial costs. The remedy lies in the establishment of independent warehouses which must be licensed. These will conform to certain conditions laid down by law in respect of such matters as sanitation, adulteration, grading and management. They will also be subject to Government inspection and supervision. The warehouse warrant would be a negotiable instrument of title, and as such available as security against a loan, or to support a hundi. Thirdly most of the transactions are carried on cash basis and even in the case of credit, only book credit is used. There is a need of the introduction of muddati hundis. They will create negotiable instruments of an acceptable kind, which can be used as and expand the basis of, credit. Fourthly, darshani hundis are supported by railway receipts only in some cases. The extension of the practice will no doubt go a long way to facilitate their purchase and discount by the banks.

In some provinces their respective governments are taking an active part in the building of warehouses by advancing part expenses. The task may be successfully taken by the Reserve Bank of India through its Agricultural Credit Department in collaboration with the Imperial Council of Agricultural Research which ought to place all its scientific resources at the disposal of the Reserve Bank for tackling the problems of grading, storing against damages, etc., involved in warehousing. The expenses may be met out of the profits of the Issue Department. Their management will also be under its control. This would make their receipts first class credit instruments.

As for financing other needs money-lenders and indigenous bankers may take upto them. They can easily combine the financing of intermediate credit needs along with short-term credit needs.

LONG-TERM CREDIT NEEDS

The Indian agriculturists require long-term credits for substantial periods, ranging from 20 to 30 years, for various

purposes, e g., repayment of previous debt belonging to both co-operative societies and money-lenders ; reclamation and improvement of land, including building of houses, sinking of wells, etc ; purchase of land ; and equipment of machinery and plant and construction of works like irrigation channels, etc. The need of the repayment of long debts of the co-operative societies and money-lenders with which the agriculturists are at present burdened has already been shown. There is a necessity of reclamation and improvement of land as well with a view to support the ever-increasing population. In certain areas, where there is no irrigation facility, wells must be sunk. There is also the necessity of building better houses for the farmers. In many cases, holdings are also very small. There is the need of the purchase of adjacent lands. Sometimes, there arises a need for the payment of money to the members of the family with a view to check further subdivision of land. Finally, with a consolidation of holdings and improvement of lands, necessity of better machinery and plant is also bound to arise. Now, loans contracted for these purposes cannot be paid within a short period. In fact, the advantages arising from them being of a permanent nature, is is but fair that their repayment should be spread over a long period

Land Mortgage Banks

There is a complete absence of any suitable agency for financing long-term needs of the agriculturists and hence they have been forced to borrow from the money-lenders at high rates of interest and under numerous disadvantageous conditions, which have in their turn imposed a chronic burden upon them. It has already been suggested that the old debts should be conciliated and considerably scaled down and repaid. The money-lenders, and indigenous bankers cannot provide for all the needs of the farmers. They should confine their operations only to short-term and intermediate credit needs. In the provision of long-term credit facilities, the state in various countries has taken an active part in providing its respective rural population with requisite land institutions. During recent years, land mortgage banks have been established in various provinces in this country as well, but their number is very

limited. In the year 1940-41, it was 252. The number of members was 1,05,280, share capital Rs. 44,14,130, debentures subscribed to by the public and the Government amounted to Rs. 302,54,188 and Rs. 6,62,572 respectively, deposits Rs. 15,20,427 reserve and other funds Rs. 13,86,370 and loans Rs. 3,22,35,248 and thus making up the whole working total to Rs. 7,04,73,035. Out of this, loans to individuals had been made to the extent of Rs. 59,35,761 and to banks and societies to Rs. 54,71,749. The position is not at all satisfactory in view of the vast size of the country.

There are three main types of such banks (i) those of strictly co-operative type, (ii) those of commercial type, and (iii) those of *quasi*-co-operative type. A land mortgage bank of strictly co-operative type is an association of borrowers who raise credit by the issue of mortgage bonds bearing interest and made payable to bearer. The commercial type has a share capital, works for profit and declares dividend. A *quasi*-co-operative type of bank has a mixed membership of borrowers and non-borrowers, operating over fairly large areas and formed with share capital and on a limited liability basis.

In India, most of the banks are of the *quasi*-co-operative type as they admit to their membership a few non-borrowing individuals for attracting initial capital as well as business talent, organising capacity and business management.

Madras leads in co-operative land mortgage banks. About the year 1925, ten institutions founded on a limited liability basis with a share capital, and the borrowing power limited to a multiple of the paid-up capital, ordinarily 8 to 10 times were started. They were authorised to issue debentures against mortgages given to them for obtaining loans. The Government also agreed to purchase debentures equal in value to which the public subscribed subject to a limit of Rs. 50,000 for one institution and Rs. 2½ lakhs for the whole Presidency. But most of the banks were not successful in selling the debentures to the public to any appreciable extent. Hence, on the recommendation of the Townsend Committee, a central land mortgage bank was established, and this became the financing and balancing centre for all other institutions. It centralised the debenture

issues, and came out to be very successful. The debentures met and are meeting with a ready response from the public and they are considered safe and secure investment even by insurance companies, local boards and trusts. The Presidency Government has guaranteed interest on all debentures. It has also lent it Rs. 15,000 as initial capital free of charge to be repaid in a course of few years. The expert staff of the Government has also been lent to it. The primary mortgage banks transfer their mortgages to the central bank, and it issues debentures with a floating charge on all such mortgages. By the year 1940-41 the number of primary land mortgage banks had risen to 119.

Then, there are land mortgage banks in various other provinces. In the year 1940-41, Punjab had 10, Bombay 18, Bengal 5 and Assam 4. Two of the Punjab banks operated over whole districts and the rest confined their operations to a single tahsil. All these provinces excepting Madras have not got central banks, and in their absence they raise capital by issuing debentures directly. A central agency is a necessity in each province. The practice of these co-operative land mortgage banks vary widely in different parts of the country. In general, it is found that in the majority of cases, the Government of respective provinces encourage actively in the growth of the land mortgage banks by guaranteeing the interest or capital or both of the debentures, and in some cases they even subscribe to them. They provide them with proper staff, audit and control as well.

Land mortgage banks can be made more effective in different ways. First of all, the practices prevailing among them should be unified. Next, a central bank is a necessity and hence it must be established in every province. In their absence, however, provincial co-operative banks may, on the lines of those of Bombay, Bengal and Punjab, be authorised to finance them through the issue of debentures. Thirdly, an alteration should be made in the Land Alienation Acts of different provinces with a view to confer free rights of transfer upon them. Fourthly, Government help will in the initial stages be required for their successful working, and hence it must be given unflinchingly. Finally, the Reserve

Bank of India can help them in various ways. So far it is prepared to grant loans and advances for periods not exceeding ninety days against Government securities in case of emergency only to those of the central land mortgage banks as may be declared to be provincial co-operative banks. It is also prepared to buy their debentures or grant loan against them provided they are guaranteed by Government both in respect of principal and interest and provided they are readily marketable. Besides, it keeps in close touch with their working and gives them the benefit of its advice whenever it is sought. It has also prepared a note on their financing and circulated to the central land mortgage banks and the registrars of co-operative societies of the respective provinces. This contains very valuable suggestions regarding the improvement in the system followed by them in floating and retiring their debentures. But much has also been left undone. It may usefully undertake to float their debentures on their behalf. Being in close touch with the money market, it knows best the most suitable time and appropriate rate of interest for their floatation. It can also tap a wider source of power than an ordinary land mortgage institution. Its association with the floatation of the debentures will also impart them a stamp of greater security. It must have some control as well on the working of the land mortgage institutions. Their books should remain open to its inspection and audit. It must also advise them with regard to their methods of business on safe and sound lines and carry on periodical examinations of the loans given by them. Then, the question of valuation of the landed property is also of very much importance. The bank can supply the land mortgage banks with expert staff for this purpose.

The land mortgage banks can only help cultivators. But there is also the question of financing other agricultural interest as well, *e.g.*, the zamindars. Hitherto, they have borrowed mostly for unproductive purposes and at very high rates of interest from different agencies. But they may be directed to borrow for productive purposes, *e.g.*, carrying on improvements in land in the methods of agriculture, and in such a case they should be assured of getting loans on low rates of interest. A mention was made of the loan offices of

Bengal in the first chapter. Both the Bengal Provincial Banking Enquiry Committee and the Central Banking Enquiry Committee, favoured some kind of control over them. At present there are numerous institutions of this type each with a small working capital. These must be amalgamated and reformed with a view to meet this demand. A well-devised legislation is necessary to achieve this end. Land mortgage banks on the joint stock principle can be evolved in other parts of the country as well for this purpose.

AGRICULTURAL CREDIT DEPARTMENT OF THE RESERVE BANK OF INDIA AND ITS ACTIVITIES IN CONNECTION WITH THE AGRICULTURAL FINANCE

Mention has several times been made of the Agricultural Credit Department of the Reserve Bank of India in this and the previous chapter. It will be useful to look to its various activities at this stage in a co-ordinated form. This department is, in fact, divided into three sections, *viz*, the Agricultural Credit, the Banking and the Statistical and Research. We are concerned here only with the activities of the agricultural credit section, those of others will be dealt with in other places.

The activities of the agricultural credit section are threefold. First of all, it studies all problems relating to rural finance, with particular reference to co-operative and to legislation for the relief of rural indebtedness. Secondly, it keeps in close touch with the co-operative movement through its officers who study on the spot its special features all over the country. The results are published in the form of bulletins. Thirdly, it places its services at the disposal of the central and provincial Governments, co-operative banks and other banking organisations which may happen to consult it on problems connected with agricultural credit.

Mention has already been made of the issue of a Preliminary Report and a Statutory Report in fulfilment of the requirement imposed upon the Reserve Bank, *vide* section 55 (1) of the Act. These along with the draft scheme for the linking of indigenous bankers with the

Bank were all prepared by this section. The credit of the publication of several bulletins as well, *e.g.*, report on the Banking Union at Kodinar, co-operative village banks, recent developments in the co-operative movement in Burma with suggestions for their applicability to India, co-operation in Panjavar, a village in the Una Tahsil of the Hoshiarpur district, Punjab, also goes to it. As has already been pointed out elsewhere various Acts passed by the Provincial Legislatures with regard to money lenders and their business were also based on the suggestions contained in the two reports, issued by it. The reduction of the stamp duty on bills also as has already been said previously was brought about due to its efforts.

But this is not all that this section can do. Development of bill market is a necessity to the country. So far the Bank charges the same rate for its loans and discounting. This section should impress upon it the necessity of charging a slightly higher rate for its loans than for discounting. It should also impress upon it the necessity of encouraging the shroffs and other urban credit agencies by various means to finance the village bankers by means of usance bills. In case of financing the cultivators as well, the village bankers can be made to adopt the system of drawing such bills with dates of maturity approximately coinciding with the probable date on which the harvest would be sold, because they can only meet their bills with the proceed of the sales. The bank like all other central banks has also got the power of carrying on open market operations, *i.e.*, direct dealings with those actually engaged in trade and industry in cases of emergency. But this section shall have to impress upon it the necessity of carrying on such operations through direct purchase, sale and discount of bills at least during the first few years, more freely and more as its normal power than emergency. For fostering the bill habit among the Indian population, it should have direct relations with the rural credit agencies, *e.g.*, money-lenders, indigenous bankers, co-operative societies and central banks and land mortgage institutions. Next, this section should maintain staff for audit and valuation in the light of the suggestions already made. This will bring about efficiency in the working of

both co-operative and land mortgage banks. Thirdly, it should get the Bank Act so amended as to bring the co-operative banks of the Native States of the country as well within its scope. At present they remain outside it. Fourthly, it should study the problems of the Loan Offices of Bengal and Nidhis and Chit Funds of Madras and take steps to reform their working with a view to make them more useful credit agencies. Fifthly, it should impress upon the bank, as has already been suggested, the necessity of dealing directly with those of the central co-operative banks as well which have reached a high standard of banking. Finally, it must establish warehouses on the lines suggested in connection with the marketing finance. By doing all these things the section will prove to be of immense benefit in solving the problem of agricultural finance.

GOVERNMENT AS AN AGRICULTURAL CREDIT SUPPLYING AGENCY

As an agricultural credit supplying agency, Government operates under the Agriculturists Loans Act and the Improvement Loans Act. In common language, the money advanced by this agency goes by the name of taqavi. The total amount distributed in normal years does not exceed several lakhs in each province. In the years of distress, however, sometimes it rises to about a crore or two. Taqavi is both short-term and long-term. Short-term taqavi is distributed generally for purchase of seed and cattle and is recoverable from the produce of the harvest for which it is given. Long-term taqavi is meant, on the other hand, to finance permanent improvements, and is repayable by instalments spreading over a number of years. Usually long-term taqavi is not easily available. Sometimes short-term taqavi takes the form of seeds as well. The distribution of taqavi is much appreciated whenever a calamity occurs, but in ordinary times the cultivator prefers to borrow from the money-lender than from the Government, in spite of his higher rate of interest. This is surely due to the defects in the distribution of taqavi. It is preceded by enquiries which are made by the lower staff consisting of patwaris and qanungos. Their recommendations do not generally bear relation to facts. The result is that taqavi goes not to

the needy but to one 'who possesses or purchases the patwaris' good-will.' The distributing centres being very few, the peasant has to waste precious time on the road. He has to wait very often for days at the distributing centre. All these things mean expenses. Besides, it is seldom distributed in time, and above all the amount allotted to the individuals falls short of the need. The methods of its collection are also very harsh. The remedy for all these evils lies in its distribution through co-operative societies. In fact, the Government cannot take up to this task very efficiently.

TEST QUESTIONS

1. What are the special difficulties of agricultural finance? Classify agriculturists' demands and explain each of your classification as clearly as you can.

2. What are the ways in which agricultural credit is made available by the Reserve Bank of India? Point out the defects from which it suffers.

3. What part Imperial Bank of India and other commercial banks play in the financing of agriculture? Explain it.

4. What do you understand by a credit co-operative society? Point out the distinguishing features of the two types usually found.

5. Give a short history of co-operative movement in this country. What is its present position?

6. What are the sources from which credit co-operative societies and banks draw their funds? In what ways do they utilise it?

7. What are the defects in the present-day co-operative movement in this country? Suggest measures to remedy them.

8. Suggest a scheme by which money-lenders may be able to play a better part in the financing of short-term need of the agriculturists. In this connection explain the working and usefulness of the Conciliation Boards.

9. What is the usual way in which agricultural marketing is financed in India? Give your suggestions to improve it.

10 Show the need of the establishment of land mortgage banks all over India. In what ways they can be made more effective?

11. What are the activities of the Agricultural Credit Department of the Reserve Bank of India in connection with the agriculture and how can it serve the country better? In this connection also point out the matters it should bring up before the Bank with a view to develop bill habit in the country.

12. What do you understand by the 'tagavi'? What are the defects with which its distribution suffers? Is it possible to improve it in any way?

CHAPTER XV

INDUSTRIAL FINANCE

The question of industrial finance is as important to the development of industries as anything else, and the fact that it has been neglected so far in this country goes to prove that the need for rapid industrialisation has not been sufficiently realised here. Whenever we talk of production, we give our attention to the products of agriculture, and the result is that our industries have been relegated to the background. Even during the period of World War II nothing substantial was done. The Government of India, on its outbreak started a Board of Scientific and Industrial Research, and since then though a huge sum has been spent on it, no active step has been taken towards establishing any industry. Whatever researches are being made, they relate to small scale chemical industries like drugs, plastics, glass-paste-board and the like. Heavy industries are out of consideration, whether belonging to the engineering group or even chemical. Under the circumstances, it is not surprising that Indians ascribe it to the influence of the British manufacturers and traders who are always out to safeguard their interests by all possible means. This also explains the cause of the Government's anxiety to solve the problems of agricultural finance rather than those of the industrial. The Congress attitude is also not encouraging. Whatever steps it took during its short regime in provinces were concerning the agricultural finance. And even now, whenever our leaders talk of industries, they talk of only cottage industries and not of factory industries. But the plan of the economic development of India recently prepared by eight industrialists of the country has given sufficient whietage to large scale industries and this may augur well for future.

REQUIREMENTS OF INDUSTRIES

Broadly speaking, an organised industry requires the

same forms of credit as agriculture, viz., short-term, intermediate, and long-term. The short-term credit is required for the purchase of raw material and stores, for expenses incidental to the marketing of products and for providing the necessary funds for paying wages and meeting day to day requirements. The intermediate credit is also required for any or all of the above purposes, in certain cases for periods varying from one to five years. The long-term credit is required for purchasing land, erecting factory buildings and installing plant and machinery in the beginning and later on for extension and re-organisation. It is also known as block capital. The relative proportion between long-term and short-term credits or block and working capitals respectively depends upon the nature of a particular industry. The more round-about, and complex the process of production, the greater must be the proportion of the former to the latter. In such organised industries as jute, cotton, iron and steel, hydro-electric and mining, the proportion of the block capital is very large. In others, e.g., drugs, plastics, glass, paste-boards, and specially the cottage industries, the opposite is the case. In short, this depends upon the value of the output and the average length of time occupied by the productive process. There may be other circumstances as well, e.g., the methods of buying raw materials and effecting sales, and those of the payment of the prices. As we shall see presently, the larger is the proportion of the long-term capital the greater is the difficulty of financing it.

PRESENT SITUATION IN INDIA

The present situation in India is far from satisfactory. It is a tradition, particularly of the British commercial banks not to take up the financing of the long-term needs. They have separate institutions for this purpose, e.g., the Securities Management Trust, and the Bankers' Industrial Department Company. In this country also, following upon the practice of Great Britain, the establishment of purely industrial banks has so often been recommended. The first attempt was, as has already been observed elsewhere, made in 1917 by the floatation of the Tata Industrial Bank. No doubt, it could not survive for long, but modelled on a

several banks were started, and of these, the Industrial Bank of Western India, the Karnani Industrial Bank, the Raikut Industrial Bank, the Simla Banking and Industrial Company, the Laxmi Industrial Bank, and certain others in native states, have been doing considerably good work. But it may be pointed out that they lack in the forceful initiative, untiring perseverance, of knowledge and organising ability which are the marked characteristics of the banks in foreign countries. Taking into consideration the vast area of the country, their number too is very small. Next, the Industrial Commission 1918 had also recommended the establishment of industrial banks working on approved lines and helped by the Government. But it was only in 1936 that the U. P. Government decided to accept the recommendations of the Industrial Finance Committee suggesting the formation of an Industrial Credit Bank to give long and short-term credit facilities to major and minor industries and also for the establishment of new enterprises on the security of both fixed and floating assets, bills of lading, etc. to encourage the purchase of machinery, etc. A year later in 1937, the Bengal Government assisted in the establishment of an Industrial Credit Corporation to provide financial accommodation to small industries in Bengal, while in 1940, similar proposal was put forward by the Bombay Economic Board. As far as Imperial Bank and other commercial banks are concerned, it may be said that they do not take up the financing of long-term needs—whatever help they give is concerning the short-term and at the most intermediate needs, and to this, we shall look in due course.

Under the circumstances, the long-term capital is derived in this country mainly from three sources. The most important of these in the earliest stages of the development of our industry was and to a very great extent even now is that subscribed to privately, on a family basis or from friends. The managing agency system originated in and is closely connected with this fact. Next is the collection in certain important places by means of deposits which are generally fixed. The last is by means of issuing shares and debentures directly to the investor through prospectuses, etc.

Managing Agency System

Taking the first, it may be said that there are individuals or firms who, possessing strong financial resources, carry out the preliminary work in connection with the starting of new concerns, promote them, act as their financiers or guarantors, and generally manage them. The main functions of these managing agents as they are called, may be summarised as follows :—

(1) They act as company promoters. "There is no doubt that one of the factors on which the success of an industrial unit depends is the careful planning of the scheme, and its launching under favourable conditions. This requires great constructive ability on the part of the organizer. Modern industry in India owed its development primarily to two classes of people. British merchants who had come out to represent British trading firms, and the cotton merchants of Bombay, and, later on, of Ahmedabad and other centres. These directly or indirectly, were responsible for much of the development that has occurred.¹ The names of Messrs. Tata Sons & Co., Andrew Yule & Co., Kettlewell Bullen & Co., Currimbhoy Ebrahim and Sons, Ltd., Birla Bros. Ltd., Shaw Wallace & Co., Nowrosjee Wadia & Sons, C. N. Wadia & Co., Bird & Co, Martin & Co., etc. may be mentioned. Some of them have the credit of promoting more than a dozen concerns.

(2) They act as under-writers of the shares of new concerns. In foreign countries, this work is performed by a special class of under-writers or industrial or commercial banks. In the absence of these, this work is performed here by the managing agents. A number of companies would have not been able to commence business, were their shares not under-written in this country by this class of people. When the shares of a newly floated concern are issued and the fact of their having been under-written by a firm of reliable managing agents is mentioned in the prospectus, it inspires confidence in the investors. If they are not subscribed to by the public in full, the

¹Industrial Organization in India—P. S. Loknathan.

residue is taken up by the managing agents.

(3) They act as managers of these concerns and in many cases their wide experience has resulted in efficiency. But there are also the cases of inefficient management. Their rights being in the past heritable, in the course of time it passed into the hands of inefficient persons. They could also be sold and transferred. Both these things have been now prohibited by the Indian Companies Amendment Act, 1936. In many cases, they being not directly interested in the fixed capitals of the concerns managed by them the interests of the shareholders are apt to be ignored and even harmed. Finally, the management becomes inefficient also due to the employment of their relatives and friends in the undertakings even if they are not worthy of the same.

(4) They establish a contact between banking and industry. 'The Imperial Bank of India Act of 1920' prohibits the bank from discounting or advancing on the security of any negotiable instrument of any individual or partnership firm payable at the town or place where it is presented for discount, which does not carry with it the several responsibilities of at least two persons or firms unconnected with each other in general partnership.' This has led to the practice of getting the signature of the managing agents on notes of hand in addition to the signature of a Director of the company who signs on its behalf. Although other banks have not to work under the same restrictions, they have more or less followed the lead of the Imperial Bank in this matter and have been unwilling to advance money on the security of the assets of a limited concern unless it is backed by the personal security of the agents themselves. In many cases even when credit is allowed on the hypothecation of goods the signature of the managing agents is insisted upon.

(5) They act as financiers of the industrial concerns as well. Due to the lack of the habit of subscribing to the shares of the companies in this country, they are in most cases undercapitalised and depend on borrowings. We have already seen that the managing agents have to put their signatures for the advances secured by them from the

banks. But in addition to this, they have also got to finance them out of their own resources.

It has already been pointed out in clause (3) that their management sometimes becomes inefficient. The chances of the same have, however, been reduced by the prohibition of the inheritance and transfer of the rights of managing agency under the Indian Companies Amendment Act, 1936. But the system suffers from a further disadvantage, and it is that it has created a divorce between banking and industry and failed to secure a proper co-ordination between the total available savings of the public on the one hand, and the industrial schemes and organising ability available in the country on the other. The dual existence of the system and the banks has retarded industrial progress. The agents tend to work in a groove, their outlook on industry becomes conservative, and they do not give sufficient attention to new industrial schemes. As they do not organise themselves into associations for active co-operation in the promotion of industry, they cannot command the services of technical and economic experts that are necessary for determining the soundness, practicability and profitability of new industrial schemes. Moreover as their financial resources are limited, they cannot promote an adequate number of new concerns even in the protected and undoubtedly profitable branches of production. In any case, they cannot have that close touch with the investing public, which banks can possess, so that they cannot float or underwrite industrial issues readily, or to a considerable extent. The system may work without much financial difficulty in a period of prosperity, but the above drawbacks become prominent when the system comes up against a period of depression. When the managing agents have to find more money during such a period to support their concerns they are often unable to do so. As has happened in many cases, when some concerns fall in difficulty, others belonging to the same managing agency are also affected thereby. The Indian Companies Amendment Act (1936) has improved the situation by laying down that no company managed by a managing agent can give any loan to or guarantee any loan made to or purchase shares or debentures of any other company managed by the same managing agent.

There is, however, no ban on the purchase of shares or debentures by a company if it is an investment company. Again, they can also be purchased, if the same is approved by a unanimous decision of the board of directors of the purchasing company. But it is inevitable that the weakness of some concerns should react on others. Finally, as in Bombay, there is enormous speculation in the shares of cotton mill companies which the managing agency system has brought about. It so happens that the managing agents control a majority of shares of the companies under their management from their start. But there is always a small group of persons who want to drive out the managing agents to get their control and whenever they learn of any weakness in their position, they bring about a considerable speculation in the shares of the concerns. In short, 'they are always ready to take the initiative at the first touch of adversity, and it is the existence of this element that supplies the key to the cornering of cotton mill shares in Bombay. Had the mills been less dependent on managing agents for their finance, such situation would not be possible, and the losses to investors owing to the enormous fluctuations brought about by speculation would have been avoided.'

We have already discussed some of the provisions provided in the Indian Companies Amendment Act, 1936, with a view to remove the defects of the managing agency system. But there are several others. All these may, therefore, be recapitulated here.

(1) No managing agent can, since the commencement of the Act, be appointed to hold office for more than 20 years at a time.

(2) Notwithstanding anything to the contrary contained in the articles of a company or in any agreement with the company, a managing agent of a company appointed before the commencement of the said Act cannot continue to hold office after the expiry of 20 years from the commencement of the said Act unless he is again re-appointed either before or after the expiry of this period. He is, however, entitled on the termination of the agency to charge from the assets of the company by way of indemnity for all liabilities or obligations properly incurred by him on behalf

of the company subject to existing charges and encumbrances, if any.

(3) A company may remove a managing agent if he is convicted of an offence in relation to the affairs of the company punishable under the Indian Penal Code, and being under the provisions of the Code of Criminal Procedure, 1898, non-bailable. Where the managing agent is a firm or company an offence committed by a member or a director or an officer holding a general power of attorney of such a company is deemed to be an offence committed by such a firm or company unless the person concerned is expelled or dismissed within 30 days of his being convicted for committing the offence.

(4) A managing agent if he is declared insolvent by a judicial sentence must also be removed from such an office of the company.

(5) A managing agent cannot transfer his right unless it is approved by the company in a general meeting.

(6) A charge or assignment of his remuneration or any part thereof effected by a managing agent is not enforceable at law against the company.

(7) Though a managing agent is entitled to receive, on the winding up of a company, all moneys due to him under the contract of management, he may not receive it in case the court finds that the winding up is due to his negligence or default.

(8) The appointment or removal of a managing agent, or any variation of his contract of management made after the commencement of the said Act is invalid unless approved by the said company by a resolution at a general meeting.

(9) Since the commencement of the said Act the remuneration of a managing agent must be based on a fixed percentage of the net annual profits of the company, with provision for a minimum payment in the case of absence of or inadequacy of profits, together with a fixed office allowance. For the purposes of this clause, 'net annual profits' mean the profits of the company calculated after allowing for all the usual working charges, interest on loans and

advances, repairs and outgoings, depreciation, bounties or subsidies received from Government or from a public body, profits by way of premiums on shares sold, profits on sale proceeds, forfeited shares, or profits, from the sale of the whole or part of the undertaking of the company but without any declaration in respect of income-tax, or super-tax, or any other tax or duty on income or revenue or for expenditure by way of interest on debentures or otherwise on capital account or on account of any sum which may be set aside in each year out of the profits for reserve or any other special fund.

(10) No company can give any loan of money to its managing agent or stand surety for any loan made to him.

(11) Except with the consent of $\frac{3}{4}$ of the directors of a company, its managing agent cannot enter into any contract for the sale, purchase or supply of the goods with the company.

(12) No company managed by a managing agent can give any loan to or guarantee any loan made to or purchase shares or debentures of any other company managed by the same managing agent. This provision does not, however, apply to the purchase of shares or debentures by a company if it is an investment company. Further, this purchase can also be made if it is approved by a unanimous decision of the board of directors of the purchasing company.

(13) A managing agent cannot exercise, in respect of any company of which he is a managing agent, a power to issue debentures, or except with the authority of the directors, and within the limits fixed by them, a power to invest the funds of the company.

(14) A managing agent cannot on his own account engage himself in any business which is of the same nature as/and directly competes with the business carried on by a company under his management or by a subsidiary company of such a company.

(15) In no case, in connection with a public company, the directors, if any, appointed by the managing agent

can exceed in number one-third of the whole number of directors.

(16) Every company managed by a managing agent is required to keep a register containing all details about the managing agent. This is to remain open to inspection by the company's shareholders.

The Collection of Deposits¹

Coming to the second, *i. e.*, the collection in certain important places by means of deposits which are generally fixed, it may be said that it is 'a reflex and a transformation of the old system of money being kept for safe custody with the mahajan.' In Bombay and in Ahmedabad, those who established the mill companies were either merchants or shroffs in whom the public had confidence, and hence it entrusted its savings to them. The sums thus deposited with the mill companies became a very important source of industrial capital for the cotton industry in both the centres, but more especially in Ahmedabad, where the amount loaned by banks was inconsiderable². In Bombay, the deposits were mostly short-period deposits for six or twelve months and were available at low rates of interest. They were very popular with the mill-owners, because they accepted them during the season when cotton was purchased for the whole year, but refused them during the later part when there was no necessity for them. But after the post-War boom when depression set in, they began to fall and at present, they play a very insignificant part in the financing of the industries there. Instead, banks have become³ more active in recent years, and now these industries depend upon them to a far greater extent. In Ahmedabad, however, even these days, deposits continue to play the same part as before, and in fact they appear to be destined to play an increasing part in future. This is mostly due to two reasons. Firstly, Ahmedabad deposits have become seven years' deposits—which means deposits for a considerable long-term. They now resemble debent-

² Central Banking Enquiry Committee, Minority Report, p. 329.

³ Central Banking Enquiry Committee quoted by Lokanathan.

tures in this respect, though there is an important difference between the two inasmuch as they have no lien on the properties or the assets of the companies like the debentures. Secondly, they represent the reserves built out of the huge profits of the mills. What is done is that the reserves of one mill are deposited in another. Thus, the Ahmedabad mills have developed a system by which they finance themselves out of their own profits and reserves. Whatever the case may be, there are still huge sums in the form of short deposits in Ahmedabad mills, and they may be withdrawn by the public to their embarrassment as in Bombay. Again, the habit of using deposits to provide capital for industries has another disadvantage, namely, that it restricts the supply of shares and debentures which are certainly better forms of investment for the public. Thirdly, mills are, by accepting deposits, doing a business for which they are not equipped, and it is possible that their failure to meet the demands of the depositors at one time or the other may frighten many people both from investing in their shares and putting in deposits with the banks. Fourthly, the present system represents the primitive banking habits which should not continue when modern banks have been established. Finally, with the increasing facilities of and confidence in modern banks including the post offices, there is every possibility of the reduction of amounts of deposit with the mills and hence they cannot be very much relied upon.

The Issuing of Shares and Debentures

There remains the last, *i.e.*, the issuing of shares and debentures directly to the public. The whole capital is not raised by one method. Both from the point of view of the concern and the investors, different methods must be adopted. They should really appeal different classes of people. First of all, there are preference shares, then ordinary shares, and finally deferred shares. Preference shares may be participating preference shares, or cumulative, or non-cumulative and so on. The raising of some part of the permanent capital by issuing debentures is also a very desirable step in many cases. While it ensures to the investors a fixed amount of annual return, it also enables the shareholders to get higher rates of

dividend in cases of huge profits. The method of direct appeal to the investors, whether by issuing shares or debentures, suffers in this country and to a small extent in other countries as well from the fact that there are times when some events create such unusual mass expectation that the investors become willing to invest money while at other times they are excessively prudent and cautious, and hence this method cannot be relied upon. In the recent history, the years 1920-21 and 1935-37 provide the illustration of the former whereas those of the intervening period, of the latter. There is also a lack of intelligent investors who may be able to distinguish between sound and unsound proposals. Even in Western countries, there is always the need of such agencies as may guide them in the selection of the different issues. In a country like India where there is a lack of sufficient education, the need is bound to be greater.

FINANCING OF INDUSTRIES BY IMPERIAL BANK AND OTHER COMMERCIAL BANKS

We know that the modern industry in India owes its origin to the managing agents. For a fairly long time they formed, in fact, the only financing agency. Their strong financial position combined with the resources of their friends enabled them to carry on without in any way depending upon the banking system. But gradually and specially when the depression set in, public confidence was shaken and they ceased to receive the help from their friends. This created the need of assistance from the modern banks. They could not surely grant them long-term credit, as the very nature of their liabilities does not warrant this. They could, however, take up to the financing of the short-term needs. But the whole of the working capital could not be provided by them. A certain proportion of working capital, although used for current expenditure, is in reality of the nature of permanent capital. The stock of raw materials, manufactured and semi-manufactured goods, never falls below a certain minimum, and the capital required for holding them is of this nature. A manufacturer should, in fact, provide for it along with the block capital. If he does not do it, he runs a great risk. Truly speaking, the mistake committed

by most of the entrepreneurs in this country was that they thought that the whole of the working capital could be raised in the form of short-term loans, and hence they failed. The banks cannot be condemned for their unwillingness and unreadiness to provide it. But we must find out whether they provided the fluctuating needs of working capital in regard to the current requirements of the industries. A close study of the facts, however, reveals that even this was not done very efficiently and cheaply. The Imperial Bank of India and other commercial banks grant loans against (i) tangible and marketable security lodged or pledged with them or (ii) personal credit of the concern but with a second signature to the pro-note of the borrower. Most of the mill-owners go without a loan for they do not like to lodge or pledge their stocks with the banks as it means a loss of prestige to them. It has already been observed that they receive deposits from the public, specially in Ahmedabad, and as the loss of their prestige has the likelihood of affecting them, they are doubly forced not to adopt this method of raising loans. The *second-name rule* has also perpetuated the system of managing agents who regard themselves indispensable to the companies managed by them, due to the need of their signatures on the hand-notes written for the purpose of taking loans from the banks. These loans take the shape of overdrafts or cash credits. Both the borrowers and the banks give preference to this practice, firstly, because the former are required to pay interest only to the extent to which the credit is availed of from day to day, subject to a certain minimum interest which must be paid in any case, and secondly, because the latter can curtail or withdraw the facilities at any time. Discounting of bills should, however, be given considerable encouragement in their method of finance. This presupposes the existence of warehouses, and development of bill habit in the country. Besides, banks do not take into consideration the personal credit and honesty of the borrowers at the time of granting loans, and demand the full security of tangible and liquid assets. In order to enable them to grant loans on the personal security as well, the provision of the Indian Companies Act requiring the balance-sheet to show separately a bank's secured advances

from unsecured advances should be repealed. Then, this will also be achieved by establishing a closer contact with and having a more intimate knowledge of the mill-owners by the bank managers. Finally, the rate of interest charged on such loans has always been very high, the smaller banks quoting 12 to 18 per cent.

Suggestions for increasing their Financial Assistance to such Industries

The Imperial Bank of India and other commercial banks and specially the strong ones can increase their financial assistance to such industries to a very great extent by adopting the following lines :

(1) They must act as the underwriters of all the issues whether of the new or old concerns. This will necessitate the maintenance of an expert staff by them, which shall study very closely the future prospects of a company proposed to be started. It will have the effect of limiting the number of concerns which have no good future prospects. Many of such companies would not have come into being as have failed due to lack of careful thinking, had this policy been followed by the banks, and thus the ruin of a number of investors would have been saved.

(2) In most cases the issues under-written by the banks shall be readily subscribed to by the public as they will inspire a better confidence, but in certain cases, it is possible that a portion of the same might have to be taken by them. These will not, however, remain with them for considerable time as the growing prosperity of the companies concerned will enable them to unload them soon in the open market and perhaps at a premium.

(3) The banks shall have also their representatives on the directorates of such companies and they will thus surely exercise a note of caution.

(4) They must make short-term advances on the personal security of the companies to some extent.

(5) Licensed warehouses must be established in important industrial centres and advances should be made on the basis of the receipts issued by them.

(6) Discounting of bills should be encouraged by charging a lower rate than for other forms of credit. This will provide the banks with the kind of the assets they need most. In their absence, they are in the habit of investing huge sums on the purchase of Government securities and treasury bills. This is not the proper function of banks. They must, first of all, help industries and trade and then the Government. It may, however, be said in this connection that in recent years, there has been a change in the attitude of most of them, and the proportion of their investment in industrial securities has been rising up. This is good and must be encouraged.

The Role of the State

There are, however, some who hold that the present stage of development of commercial banks in India does not warrant their taking substantial interest in the long-term finance of industry. In their stead, they suggest that the Government should come forward. This opinion has recently received a fillip because of the move of the people towards socialistic tendencies. But our Government being alien, we do not think that any advantage can accrue by Government's participation in our industries. It owns, however, in this country, ordnance factories, public utilities and railways and has recently decided to take up the bulk generation of electric power. It may also take up basic industries of national importance provided adequate capital is not forthcoming from private sources.

SUGGESTIONS FOR STARTING MORE INDUSTRIAL BANKS

It has already been pointed out that taking into consideration the vast area of the country, the number of existing industrial banks is very small. If the Imperial Bank of India and other commercial banks increase their assistance to industries by adopting the methods already suggested, the necessity of floating more industrial banks will not arise. But, if they do not take up this task, industrial banks must be established to fulfil the gap, and in such a case their functions will be the same as laid down for the Imperial Bank and other commercial banks. The

existing industrial banks will also do well to improve their business on these lines and to become more useful to industries. In the words of the British Committee on Finance and Industry their functions will be as follows:— 'Acting as financial advisers to existing industrial companies; advising in particular as to the provision of permanent capital, its amounts and types; securing the underwriting of and issuing the company's securities to the public and, if necessary, assisting previously in arranging for the provision of temporary finance in anticipation of an issue; assisting in financing long contracts at home and abroad or new developments of an existing company; or founding companies for entirely new enterprise; acting as intermediaries and financial advisers in the case of mergers or in the case of negotiations with corresponding international groups; and generally being free to carry out all types of financing business. Such banks will surely raise funds in the form of long-term deposits; not short-term. In fact, they must not be allowed to compete with the already existing commercial banks.

Provincial Industrial Corporation as an Agency to Finance Public Utility Industries

Although the establishment of state-aided industrial corporations by the provincial governments for the purpose of financing all kinds of competitive industries has been recommended by the Central and six of the Provincial Banking Enquiry Committees, it can be ruled out for certain well-known objections against it. First of all, the burden of establishment of such institutions will fall on the tax-payers who will certainly resent it. Next, if the Governments have got funds to take up this task, there are many others, which being more important, must precede it. Thirdly, it is not reasonable that state-aided institutions should be allowed to compete with private enterprise. But there is a case for their establishment for the purpose of undertaking the financing of several public utility industries. Already the need for such an institution has been felt in some provinces. In Madras, the hydro-electric undertakings, power supply schemes and the irrigation works were all financed by Government; but the machinery for financing

the schemes was ill-organized. Same was the case in the Punjab also. These public utility undertakings have one thing in common, namely, that the capital invested therein takes some time before yielding returns and, therefore, the ordinary methods of a company financing are not suitable. They, however, afford a very valuable means of drawing capital from the investors provided a suitable financial machinery is devised. The starting of a public industrial corporation for the purpose of financing all semi-monopolistic industries will be not only desirable but necessary, if financing is to be done efficiently. The 'foreign' experts who came to assist the Banking Committee also held the same view. There was, no doubt, some difference in the earlier stages on the character of such institutions, but this was later on reconciled. As opposed to the Central and six of the Provincial Banking Committees, they favoured in the beginning an all-India institution. The same opinion was also held by Mr. Subhedar and some witnesses before the committee. In fact, there were weighty arguments advanced by both the sides. Those in favour of provincial industrial corporations are as follows :—

(1) Industry being a provincial subject, any scheme to promote it must be shaped and controlled by provincial governments.

(2) The financing of provincial corporations by their respective provincial governments will be easier than that of an all-India institution by the Central Government.

(3) It will be easier for the provincial corporations to raise capital by appealing to the provincial patriotism than for an all-India institution.

(4) Provincial institutions are better fitted to understand the needs of the industries of their own provinces than an all-India institution to understand the needs of the industries in different provinces.

(5) As a corollary to clause (4) provincial institutions shall have technical experts concerning the industries of their own provinces, and will be able to employ them for whole time, while an all-India institution shall need technical experts concerning industries spread over the whole

country and shall not be able to employ them for the whole time. In fact, concentration will not be possible in the latter case.

The arguments of those favouring the establishment of an all-India corporation were as follows :—

(1) The financial position of the provincial governments does not warrant them to take up the task. On the other hand, the Central Government is better fitted to do so. In case of its failure to provide all the assistance itself, a part of the burden may be distributed among the provincial governments on an equitable basis.

(2) The issues of an all-India concern assisted by the Central Government will inspire a better confidence in the public, and hence all the shares and debentures floated by it will be easily subscribed. Such issues will also find market in foreign countries, if necessary. An all-India institution will be able to select directors from all over the country, and this will surely lead to an efficient working.

(3) The funds of an all-India concern will be distributed over a variety of industries and a very wide area, and hence it will be able to pass through a difficult period of economic depression without considerable risk.

(4) An all-India concern shall have a greater voice in the enactment of laws affecting trade and industries in the country. It shall be able to throw a greater weight on the policies of the Government regarding tariffs, railway rates and purchase of stores, all these being central subjects.

(5) The staff of a central institution drawn from all over the country shall have a wider knowledge and better understanding capabilities. The industries of one province shall be able to take advantage of the experience obtained in other provinces. An all-India institution shall be able to have wider information. It will also be able to draw on the experiences of the foreigners.

(6) There are in this country at this stage vast resources which have so far been lying unexploited, but all of them cannot be taken up at once. An all-India concern shall be able to select the most prominent projects in the

beginning and postpone the less prominent for the future.

But in the end unanimity was obtained on this point, and both the sides being impressed by the arguments of each other, decided to have provincial industrial corporations with a central association to safeguard and promote the common interests. The functions of the latter were laid down as follows :—

(1) Assistance to the provincial corporations to secure subscriptions from the public for their shares and debentures.

(2) Co-ordination of their activities and checking of any tendency on their part to give preference to certain industries over others.

(3) Laying down of certain general principles for their guidance.

(4) Securing for them concessions from the Central Government.

SUGGESTIONS FOR POPULARISING THE INVESTMENT BY THE PUBLIC IN THE SHARES AND DEBENTURES OF INDUSTRIAL CONCERNS

(1) A number of companies were floated during the boom period following World War I. Their failure, when depression set in, led the people, to lose confidence in this form of investment. They prefer to invest their savings in loans to neighbours, landed property or Government, Municipal or Port Trust securities. In case, the existing banks or those proposed to be floated, begin to examine the schemes before a new concern is floated, there is every likelihood of a reduction in their failure, and this will surely inspire a better confidence in the public.

(2) Some witnesses before the Central Committee mentioned that the reluctance of the people to invest in industrial issues is also due to the public belief that the industrial policy in this country is not determined by a government responsible to the people. A change in the attitude is sure to improve matters.

(3) The reluctance of the people and specially those

residing in rural areas and small towns is also due to the absence of agencies capable of bringing them into touch with such securities. A larger advertisement and propaganda may prove very useful.

(4) Most of the people are uneducated and do not understand the methods of modern finance. Mass education and training will go a long way to meet this situation.

(5) There are no organisations to facilitate the purchase and sale of industrial securities with the exception of a few and those too only in important towns. Introduction of the firms of reliable share-brokers is a real necessity felt by genuine investors.

(6) Stamp duty on the transfer of certain kinds of issues is exorbitantly heavy; its reduction is very necessary.

(7) It becomes usually very difficult for the holders of small number of shares to unload them in case of emergency. Dealings in small units should be encouraged.

(8) No institution is ready to lend freely on the security of industrial scrips. Our banks also give preference to Government securities. In recent years some change has, however, been brought about in their attitude.

(9) Since 1920, the Government of India has been, like the Governments of other countries in their respective markets, a serious rival of the industrial concerns in the Indian capital market. It should, in fact, attract investment at very low rates of interest in order to counterbalance the safety it affords.

SUGGESTIONS FOR IMPROVING THE FINANCE OF COTTAGE INDUSTRIES

Cottage industries also require finance, and at present they are the monopoly of the rapacious and short-sighted money-lenders and indigenous bankers. Their small size and scatteredness is bound to be an impediment for all times to come, to draw the attention of the banks and big financiers, possessing enlightenment and vision. But these features make them fitted for the application of co-operation, and various committees have expressed this opinion

more than once. Such industries thrive in Germany and Japan with the help of co-operation, and there is no reason why they should not do so here in India. But, for this purpose, co-operation should not be introduced only in the realm of credit. Just as in agriculture, it must be introduced here also in other realms as well. The need for co-operative organisation of artisans, craftsmen and other small-scale producers against the growing power of large-scale machine industry is only too apparent.

Though the Co-operative Societies Act of 1904 permitted the organisation of urban societies, it was not before the lapse of a considerable time that they were really started. As has already been observed, these societies differ a good deal from those of the agriculturists in the matters of their constitution and working. Urban co-operative societies are, however, of various kinds, e.g., employees societies, consumers co-operative stores, artisans and weavers societies, milk unions and societies, insurance societies, housing societies, students stores, etc. But we are concerned here with only artisans and weavers societies. The word artisans includes all industrialists carrying on the work of production under what is known as the small-scale system of production but so much importance has been given only to the weaving as weavers industry is in fact the most important industry which is being carried on in India under this system. At the end of the year 1939-40, there were 39 weavers societies in Bombay, 191 in Madras and more than 350 in the Punjab. Statistics of such societies in other provinces are not available, but it is certain that there are at least some in each province. Besides, there are many other societies formed by the artisans other than the weavers. No statistics are available regarding them. They have also been given a considerable filip because of the increasing success of the cottage industries due to war conditions. No doubt, the existing artisans societies are mainly credit-supplying societies, yet they can do a lot by taking up the questions of the purchase of raw materials, sale of the manufactured articles and provision of better tools and implements. At present, the money-lenders carry on all these duties. In all the important towns, there are some industries carried on under

small scale, and there are also the money-lenders-cum-traders in these places who provide them with raw materials and purchase the whole produce at a very low cost to be sold by them at very high prices. In case these functions are taken up by the co-operative societies, there is bound to be brought about a good deal of improvement in the conditions of the artisans. The sooner the step is taken, the better it will be.

Industry is a provincial subject, and various provincial Governments have been doing under their limited spheres what they could for their development. Some of them have been rendering financial assistance to various industries, of which the small-scale industries form an important part, under State Aid to Industries Acts and Industrial Loans Acts. This assistance takes the form of loans at low rates of interest, supply of machinery on the hire purchase system, grant of land or other Government property, etc. They also carry on propaganda, demonstrations and provide for technical assistance. But from the reports published so far, it appears that the success has not been attained up till now to any considerable extent. The finance provided under them has been very small, and it becomes really difficult for a genuine industrialist to obtain it. A part of the loan thus advanced has also had to be written off, and the recovery of a very considerable portion is doubtful. In fact, Government agency cannot successfully tackle this problem. If it wishes to take up the question of finance it must take it up only through co-operative societies or provincial co-operative banks proposed to be started. The latter can really be of much help to cottage industries. But the Government can help the industries whether organised on a large scale or a small scale in various other ways. Its store purchase policy alone can do a lot.

CONCLUSIONS

In fact, no positive conclusions can be arrived at with regard to the industrial finance. There is a need of an all round development in the country. More of the purely industrial banks should be started and they should work on the lines which must be chalked out after taking into

consideration the experience gained so far. The Imperial Bank of India, and other commercial banks specially which are sufficiently strong must combine industrial banking with commercial banking on the lines of the mixed Continental system of banking. Further, if necessary, provincial industrial corporations may also be started for the financing of public utility concerns. As far as the direct financing by the state is concerned, it will do well to confine its activities only to the rendering of assistance to the industries in other ways than financial. Industrial banks, or commercial banks or provincial industrial corporations can be helpful only during the intervening period between the establishment of a concern and its coming up to a standard. The ultimate burden is under all circumstances to be borne by the individual investors, and this can be only done by popularising their investments in the issues of the industrial concerns. Imperial Bank and other commercial banks shall have, however, to bear the burden of financing the short-term needs of the industries. The establishment of co-operative societies will be of great benefit to cottage industries. In fact their salvation lies in them.

TEST QUESTIONS

1. What are the financial needs of the industries? Point out the relative importance of each discussing the various factors upon which their respective amount depends.
2. What agencies finance the long-term needs of the industries in this country? Discuss in this connection the merits and demerits of each. What part have the Indian industrial banks played so far with regard to it?
3. What are the ways in which Imperial Bank and commercial banks finance Indian industries? Give your suggestions to make them more useful.
4. What is your opinion with regard to the establishment of the Provincial Industrial Corporations? Vindicate in this connection the need of an all-India institution.
5. What measures should be adopted to popularise investment by the public in shares and debentures of industrial companies? Why have they not been popular so far in India?

CHAPTER XVI ·

COMMERCIAL BANKS

Truly speaking, under this heading should be included the Indian joint stock banks, the Imperial Bank of India, and the foreign banks, as all of them carry on commercial banking functions. But for the sake of convenience, we shall deal only with the Indian joint stock banks here; the Imperial Bank of India and the foreign banks shall be taken up in subsequent chapters. It will, however, include the existing industrial banks. They carry on, in fact, commercial banking functions as well side by side with whatever industrial banking functions they perform. They have been just like other Indian joint stock banks formed under the Indian Companies Act. A historical review of commercial banks having been already made in Chapter I, we shall discuss here only their present position and working operations.

ORGANISATION

An Indian joint stock bank is required to be registered under the Indian Companies Act. Until the beginning of 1937, it was governed by its general regulations, with the exception that in a few matters a distinction had been made between a banking company and others. These related to :—

(i) the maximum number of partners in a partnership which could not exceed ten in the case of a banking concern, though it could be twenty in the case of others ;

(ii) the compulsory filing of a list of all its places of business by a banking company with the registrar ;

(iii) the compulsorily supplying him periodically by a banking company with its balance-sheet drawn up in a certain form in which secured and unsecured debts were required to be shown separately (there was, however, no necessity of disclosing in it the provision made for bad and doubtful debts) ;

(iv) the examination of its position by the provincial government concerned through one or more inspectors on the application of members holding not less than $\frac{1}{3}$ of its issued shares, the proportion being $\frac{1}{10}$ in the case of others

The general opinion in the country was that this was not sufficient for the regulation of banking and had left many banking institutions altogether free from it. The Central Banking Enquiry Committee was in favour of a special Bank Act. The foreign experts, on the other hand, recommended only certain modifications and additions. The Government of India, agreeing with the latter, introduced the following in the Indian Companies Amendment Act, 1936 :—

(1) A definition¹ of a banking company. This is, however, not very satisfactory. It was mentioned on page 4 and has been pointed out by the authorities of the Reserve Bank of India, that there are a large number of the non-scheduled banks operating in British India which claim that they are not banks and do not submit the prescribed cash reserve returns.

(2) A restriction on the registration of a banking company if it does not limit in its memorandum its objects to the carrying on of the business of accepting deposits of money along with some or all the forms of business specified in the definition. Those already registered on the date of the commencement of the Act and doing any business, not included in it were asked to give it up within a period of two years after it.

(3) A restriction on the management of a banking company by a managing agent other than a banking company after two years of the date of the commencement of the Act.

(4) A restriction on the commencement of business by a banking company registered under the Act without the allotment of shares sufficient to yield at least Rs. 50,000 as working capital and without filing with the registrar a

¹Please consult Appendix A.

declaration signed by its directors and manager to the effect that this amount has been received.

(5) A restriction on a banking company to create any charge on its unpaid capital.

(6) An obligation on every banking company, except a scheduled bank of the Reserve Bank, to maintain a reserve fund from the commencement of the Act and to transfer to it not less than 20 per cent of its annual profits before any dividend is declared until the reserve fund is equal to the paid-up capital. It is also required to be invested in Government or Trust securities or deposited in a special account opened in a scheduled bank of the Reserve Bank. The latter provision was to be applied to a banking company already in existence after two years of the date of the commencement of the Act.

(7) An obligation on every banking company other than a scheduled bank of the Reserve Bank of India to maintain a cash reserve of at least $1\frac{1}{2}$ and 5 per cent of its time and demand liabilities and file with the registrar every month a statement of the liabilities and cash reserve held on Friday of each week of the preceding month. In case of a default of this provision, every director or officer of the bank who is knowingly a party to the default is made liable; to a fine for every day during which the default continues.

(8) A restriction on a banking company to form, or hold shares in, any subsidiary company except a subsidiary company formed of its own, for the purposes set forth in the definition.

(9) The power of a court of law on the application of a banking company, temporarily unable to meet its obligations, accompanied by a report of the registrar on its financial condition, to pass an order staying the commencement or continuance of all proceedings against it on such conditions as it may think fit and to extend it from time to time, or to grant interim relief, even if the application is not accompanied by a report of the registrar.

(10) A restriction on the appointment of persons indebted to a company whether banking or otherwise as

(2) No banking company incorporated under this Act on or after the 15th day of January, 1937, shall, after the expiry of two years from the commencement of the Indian Companies Amendment Act, 1944 carry on business in British India unless it satisfies the following conditions, *viz.* :—

(a) that the subscribed capital of the company is not less than half the authorised capital, and the paid-up capital is not less than half the subscribed capital, and

(b) that the capital of the company consists of ordinary shares only, or ordinary shares and such preference shares as may have been issued before the commencement of this Amendment Act, only, and

(c) that the voting rights of all share-holders are strictly proportionate to the contribution made by the shareholder, whether a preference shareholder or an ordinary shareholder, to the paid-up capital of the company.

But the need for a single consolidated, up-to-date banking law for the whole of India has been long felt, and "this need has become the more insistent, because of the considerable development that has taken place in recent years in banking." Hence, a bill purporting to consolidate and amend the law relating to banking companies, was introduced in the Central Assembly in November, 1944. Its main features are as follows :—

(i) A simple definition of banking with the object of limiting the scope of the legislation to institutions in which the funds are deposited primarily to ensure the safety and ready withdrawability ;

(ii) Prescription of minimum capital standards ;

(iii) Prohibition of trading with a view to eliminating non-banking risks ;

(iv) Inclusion in the scope of the legislation of banks incorporated or registered outside British India ;

(v) Provision of an expeditious procedure for liquidation ;

(vi) Inspection of the books and accounts of a bank by the Reserve Bank when necessary ;

(vii) Empowering the Central Government to take action against banks conducting their affairs in a manner detrimental to the interests of the depositors ;

(viii) Prescription of a special form of balance-sheet and conferring of powers on the Reserve Bank to call for periodical returns.

CLASSIFICATION

Commercial banks have been divided into four classes, viz., (1) those having a paid-up capital and reserve of Rs. 5 lakhs and over, (2) those having a paid-up capital and reserve between Rs. 1 lakh and Rs. 5 lakhs, (3) those having a paid-up capital and reserve between Rs. 50,000 and Rs. 100,000, and (4) those having a paid-up capital and reserve of less than Rs. 50,000.

The first group consists of (a) Scheduled banks and (b) non-scheduled banks. The number of the former on 30-6-'45 was 73 (including Imperial Bank) and that of the latter 35 (in December, 1943). Sec. 42(6) of the Reserve Bank of India Act provides that the Central Government shall, by notification in the Gazette of India, direct the inclusion in the second schedule, of any bank not so included which carries on the business of banking in British India and which (a) has a paid-up capital and reserve of an aggregate value of not less than Rs. 5 lakhs, and (b) is a company as defined in clause (2) of section 2 of the Indian Companies Act, 1913, or a corporation or a company incorporated by or under any law in force in any place outside British India, and shall by a like notification direct the exclusion from that schedule of any scheduled bank the aggregate value of whose paid-up capital and reserve becomes at any time less than five lakhs of rupees, or which goes into liquidation 'or otherwise ceases to carry on banking business'. Prior to May 1940, banks were included in the second schedule mainly on the strength of their audited balance-sheet or statement of auditors showing their paid-up capital and reserve at Rs. 5 lakhs or over. In view of certain difficulties experienced by Government in including banks in the schedule, they ruled that the words 'aggregate value of paid-up capital and reserve' occurring in the above section of the Act should be interpreted to mean the real or the exchangeable

value of the paid-up capital and reserve and not the book value as shown in the balance-sheet. In pursuance of this decision a new procedure for inclusion of banks was drawn up, under which the Reserve Bank agreed to co-operate with Government in evaluating the paid-up capital and reserve and also in inspecting the books of the applicant bank if deemed desirable. The banks included in (a) are such banks and they have certain obligations to fulfil and privileges to receive in this capacity. The banks included in (b) are, however, such as have not been included in the list of the scheduled banks due to one or the other reason. Some have been registered and work only in Indian States. They cannot be included in the second schedule because they have no branches in British India.

The second, third and fourth groups consist of non-scheduled banks. The number of the first two of them at the end of 1943 was 152 and 141 respectively and that of the third at the end of 1942 was 133.

It may be added here that all the banks included in the fourth group were those which had been established before the passage of the 1936 Amendment Act. Since then, no bank can be started without having a paid-up capital of at least Rs. 50,000. Besides, the combined capital and reserve of all the banks has been increasing gradually due to the provision (6) of the Indian Companies Amendment Act as laid down previously in this book.² It may be interesting here to note the decline in the number of such banks due to the above reasons. At the end of the years 1939 to 1942, they numbered 400, 332, 147, and 133 respectively. Subsequent figures are not available but they too must show the same tendency. The total number of all non-scheduled banks which reported³ to the Reserve Bank of India at the end of 1944, was, however 613. This, of course, includes all institutions using the word 'bank' as part of their name whether accepting deposits on current account or not as per the proviso added in 1942 to the section empowering the Reserve Bank of India to get a report of all banks in this

²Please refer to page 267 of this book.

³Please refer to page 5 of this book.

country. A number of such banks should not be called banks. They use this title simply to get a distinction.

PRESENT POSITION

World War II has had a great effect on banking in this country. New institutions have been established and the old ones have expanded themselves. The reason for this is not that the war gave the banks a greater opportunity to finance internal trade and industry. The fact, on the contrary, is that they were deprived during the war period of even the opportunity they had before it as the Government itself advanced all the finance needed by the concerns engaged in the supply of war goods. Besides, the soaring profits made by the industries themselves enabled them to be largely independent of bank credit. Government also came out with Ordinances against advances on the pledge of grain, bullion, etc. But their total deposits have been going up and this fact has given a greater stimulus to banking in this country than any other. The importance of India as a base of military operations was discerned at a very early stage of the war. This necessitated a great increase in expenditure by the Government of India both on its own account and also on account of the allies. The result has been a continuous and enormous increase in the currency, largely of note-issue, and hence in the deposits of the banks. There were checks to the increase in the latter, occasioned by unfavourable turns of the war, but they only served to underline the resilience and strength of the banking system.

Since the war broke out, i.e., September, 1939, the number of the scheduled banks has been going up—not less than 32 having been included in the list up to the end of June, 1945. Some of these are, of course, from amongst those which were working in this country even before. But quite a good number consists of the newly started concerns. A few non-scheduled banks have also been established during this period.

The number of the branches of the scheduled as well as non-scheduled banks has also been rising. While all scheduled banks had about 1250 offices in 1939, by June 1945, they had 2715 offices. Of the latter, if we exclude those of

the Imperial Bank of India (426) and the exchange banks (80) Joint Stock banks alone accounted for 2209 offices. It is a matter of great satisfaction that quite a considerable number of these offices has also been opened at places which were not served previously by any bank whatsoever. Finally, the increase in bank branches was due both to the establishment and inclusion of the new banks in the second schedule and to the opening of new branches by old institutions.

The deposits of both the Scheduled and non-Scheduled banks have also grown up during this period. The total deposits of the former amounted to Rs. 236 60 crores on September 1, 1939, and those of the latter to Rs. 15.96 crores on December 31, of the same year. In comparison to this the respective figures for the one were Rs. 865.81 crores on July 20, 1914, and for the other Rs. 46.80 crores on November 24, 1914. Of course, the figures for the scheduled banks include those of the Imperial Bank and the Exchange Banks as well. But it may be concluded safely that the increase is all round, not one-sided.

The banks have also increased their capital. The bigger banks, like the Central Bank of India and the Bank of India, did so with a view to maintain the percentage of the same to deposits. In doing so, they took the advantage of market conditions and by issuing their shares at a premium added to their reserves as well. The smaller banks, however, did so with a view to attain the status of scheduled banks. Their reserves have also been going up due to the provision 6 of the 1936 Companies Amendment Act. The desirability of this tendency to increase capital has been questioned in many quarters. It is contended that there is nothing sacred about the ratio of capital to deposits and that its gradual decline need not cause any perturbation in banking circles. It is apprehended that an inflated capital structure may well prove a temptation to unsound investment and besides become a dead weight on earnings. From amongst the newly started banks, the capital structure of Bharat Bank (more than Rs. 2 crores) is bigger than that of even any of the 'big five' that of the Hindustan Commercial Bank (about Rs. 1½ crores), is next to only first of them, i.e., the Central, and of

the United Commercial Bank, to only first and second of them, i.e., the Central and the Bank of India.

Their cash position has also been improving. While in the early thirties, they maintained a balance of about 15% of the deposits, at present they maintain a balance of about 25% of the same. This is certainly not desirable from the point of view of earnings but has to be done in this country where cheque habit has not much developed and confidence is easily shaken specially during war period on the receipt of the news of reverses. With the restoration of peace, the policy might have to be changed.

OPERATIONS

Besides attracting deposits of all kinds, these banks finance whatever trade and industry they can, open cash credits, discount bills and hundis, provide remittance facilities and render other services to the people. We already know of the part played by them in connection with the financing of agriculture and industry. In a subsequent chapter, we shall also look to the part played by them in financing foreign trade, though it may be mentioned here that they do not take up this business to a very great extent. Whatever part they play in this connection is confined only to the movement of goods from ports to the consuming centres and from mandis to ports. Their share in this part of the business also is not what it ought to be mainly because of the opening of their branches by the foreign banks in the interior or the establishment of their connection with a few of them specially those managed by Europeans.

Taking *deposits* first as we have seen, it has been steadily growing and specially during war-period. As in most cases the amounts of various deposits are not given separately nor it can be formed of the distribution of total amount between them. There is, however, some information regarding the demand and time deposits of the Big Five of the joint stock banks and for a few years, of the scheduled banks in which the former are, of course, included. This reveals that the

ratio of the former was 13.1 to 86.9 in 1913 ; 34.8 to 65.2 in 1920 ; 33.4 to 66.6 in 1926 ; 35.0 to 65.0 in 1929 and 49.1 to 50.9 in 1935 and of the latter 54.6 to 43.4 in 1936 ; 54.8 to 43.2 in 1938 ; 57.1 to 42.9 in 1940, and 76.2 to 23.8 in 1942 ; and 72.99 to 27.01 in 1944. It is a proof of the rising tendency of the demand deposits over time deposits, and would have ordinarily reflected a development of the banking habit in the country. But, under the present circumstances, it is indicative merely of the smallness of time deposits. Several causes have been at work to diminish the volume of fixed deposits in this country.

First of all, after 1920, post office savings bank accounts and cash certificates had become increasingly popular. The figures of the former for 1920 and 1939 were Rs. 2,131 lakhs and Rs. 8,444 lakhs respectively, and of the latter for 1920 and 1936 were Rs. 575 lakhs and Rs. 6,598 lakhs respectively. Since, they have been falling of course. This was not only due to the confidence which post offices inspire in a country like India, but also due to the course of interest rates offered by them.

Next, life insurance and various kinds of government securities and stocks and debentures of industrial companies also show the same tendency. 'Funds which used to appear formerly as fixed deposits, now pause for a while as current deposits on their way to absorption in permanent investment.'

Interest rates⁵ offered on all sorts of deposits have also got a good deal of effect on their distribution. But no separate records for rates paid on fixed and current deposits are available in India except those for the Central Bank of India. There are, however, records available of the average rate paid on both types of deposits taken together for almost all the banks. Usually no interest ought to be paid on current deposits, and this is the practice which prevails in most of the other countries. We know that 'demand deposits' are sought by the public more as a

⁵For this portion, the author has relied mainly upon *Modern Banking in India*—Muranjan.

their progress.

[In thousands of Rupees]

Name of Bank	Year	Deposits				
		Fixed	Savings	Current	Others	Total
Imperial Bank of India.	1939	...	...	...	...	87,84,16
	1940	...	...	...	...	96,03,17
	1941	...	...	...	...	1,08,91,90
	1942	...	...	...	...	1,63,46,48
	1943	...	...	...	...	2,14,52,80
	1944	...	...	...	...	2,34,22,00
Central Bank of India.	1939	11,62,00	...	18,21,82	...	29,86,82
	1940	10,86,38	...	21,63,50	...	32,49,88
	1941	12,03,12	...	29,28,78	...	41,31,90
	1942	11,51,46	...	45,13,88	...	59,65,34
	1943	14,08,42	...	67,55,29	...	81,63,71
	1944	18,61,08	..	75,87,58	...	94,48,66
Bank of India ...	1939	...	...	...	...	18,59,51
	1940	...	...	...	...	22,27,61
	1941	...	..	...	...	25,86,03
	1942	...	...	...	...	36,82,34
	1943	...	...	...	...	55,13,88
	1944	11,02,43	...	49,80,28	...	60,82,71
Allahabad Bank...	1939	6,08,97	1,58,74	3,27,49	20,97	11,16,17
	1940	6,62,57	1,56,61	3,68,67	1,94	11,89,79
	1941	6,23,96	1,37,59	5,33,80	2,29	12,97,64
	1942	5,36,26	1,62,50	9,83,26	2,41	16,84,43
	1943	7,87,13	1,91,37	11,06,52	2,58	20,87,60
	1944	...	...	...	...	...
Punjab National Bank.	1939	5,50,75	...	1,59,13	5,17	7,15,05
	1940	5,58,77	...	2,38,02	6,18	8,02,97
	1941	6,01,42	...	3,71,22	7,66	9,80,30
	1942	7,49,23	...	7,87,57	9,53	15,46,33
	1943	13,06,14	...	13,36,72	...	26,43,16
	1944	20,70,72	...	16,78,02	27,06	37,75,81
Bank of Baroda...	1939	2,61,72	...	4,32,59	5,43	6,99,14
	1940	2,51,70	...	4,90,80	5,99	7,48,49
	1941	3,36,13	...	6,23,88	...	9,60,01
	1942	2,83,06	...	10,43,66	...	13,26,72
	1943	5,07,83	...	15,66,12	...	20,73,95
	1944	6,15,73	...	20,23,26	...	26,38,99

[In thousands of Rupees]

Name of Bank	Year	Deposits				
		Fixed	Savings	Current	Others	Total
Bharat Bank ...	1943	5,22,10	...	8,62,06	11,24	13,95,70
	1944	...	...	...	...	20,41,00
United Com Bank	1943	3,03,01	...	9,74,15	...	12,77,19
	1944	8,57,02	...	13,65,23	...	17,22,25

✓ As regards the financing of trade, it may be said that it takes various forms. As between long-term and short-term loans, the rate of interest on the latter being very attractive at present, and the characteristics of their liabilities being mostly short-term, the commercial banks prefer it. From amongst these, taking the loans and advances first, their proportion to total deposits does not appear to be so high in this country as in several others. The same is given in the following table for the Imperial Bank of India and 'Big Five' for three continuous years in order to give an idea of it :

PERCENTAGE OF LOANS AND ADVANCES TO TOTAL DEPOSITS

	As per B/S prepared in 1941	As per B/S prepared in 1942	As per B/S prepared in 1943
Imperial Bank of India ...	33	17	15
Central Bank of India ...	40	23	28
Bank of India ...	40	25	24
Allahabad Bank ...	33	33	35
Punjab National Bank ...	44	29	32
Bank of Baroda ...	48	28	30

From the above nothing can be, truly speaking, said very definitely. In the case of some of the banks the percentage is higher than in the case of others. There is also a very wide difference between the percentages in one year and the other. They are sufficiently elastic and may be taken to be capable of responding to the needs of the trade. These loans and advances include those for agriculture and industries as well, however insignificant their amount may be, and hence we are unable to form an exact idea of the extent of their assistance to trade generally.

We must also look to the forms these loans and advances usually take. Cheque habit not being very popular in this country, it may be said that the amount of cash loans is very considerable. The securities generally offered for this purpose consist of land and buildings, ornaments, bullion and government papers. There is a decreasing tendency amongst the banks to agree to the granting of such loans. As far as possible, they try to persuade the borrower first of all to open a current account with them and then sanction an overdraft to a limited extent. In most cases, the margin kept is not less than 30 per cent. Granting of loans in the form of cash credit is, however, the most important of these, because of the obvious reasons that it is beneficial both to the bankers and borrowers. The former, as we know, can at any time cease to advance money on it, while the latter is required to pay interest only on the amount actually standing against his debit at the end of each day. The basis for such credits is usually the trading stock of the borrower, which may be kept in his own godown or in that of the banker. In the former case, the banker puts his own locks and signboard and in the latter he charges godown rent. In both cases, they must be insured, and the premia, therefore, naturally falls upon the borrower. Loans against the borrower's personal security are very rare, and whenever they are granted, a two-named paper is, without any exception, secured.

Coming to the discounting operations, it may be said that they are not very popular here. The value of bills discounted by the scheduled banks on 13-7-45 was Rs. 14'62

crores compared with their total deposit liabilities of Rs. 863 74 crores. The following table shows the percentage of Bills discounted to total deposits in respect of the Imperial Bank of India and the 'Big Five' for three continuous years :—

PERCENTAGE OF BILLS DISCOUNTED TO TOTAL DEPOSITS

			As per Balance Sheet in		
			1941	1942	1943
Imperial Bank	...	...	7'1	4'1	3'4
Central Bank	...	...	6'4	3'7	4'8
Bank of India	...	...	2'6	0'6	0'5
Allahabad Bank	...	...	2'1	3'1	3'7
Punjab National Bank	...	...	...	...	...
Bank of Baroda	...	...	2'3	0'3	0'4

This is very discouraging and efforts must be made to improve the matters, as we know that this form of investment is the best from the banker's point of view. It may, however, be added that of the newly established banks, Discount Bank of India, United Commercial Bank and Bharat Bank have been taking up this business to a greater extent.

Finally, we have to take up the investment in government and other securities. The figure available also includes the fixed deposits of one bank with the other, and hence nothing can be said very definitely with regard to it. But an approximate idea can be formed from the following table :—

PERCENTAGE OF INVESTMENTS IN GOVERNMENT AND OTHER
SECURITIES AND FIXED DEPOSITS WITH BANKS TO
TOTAL DEPOSITS

	As per B/S prepared in 1941	As per B/S prepared in 1942.	As per B/S prepared in 1943
Imperial Bank of India ...	64	72	63
Central Bank ...	51	61	55
Bank of India ...	45	55	57
Allahabad Bank ...	49	51	49
Punjab National Bank	51	61	51
Bank of Baroda ...	48	55	60

A high percentage of investment in Government securities is desirable from the point of view of realisability at any time but is not so from the point of view of helping the trade. The higher is the percentage of loans and advances and bills discounted, the better it is. It may, however, be said that during war-period the tendency for the investments in Government securities has become still more marked than what it was during the pre-war period.

Indian joint stock banks also provide remittance facilities and render other services to the public. As far as the provision of the remittance facilities is concerned, the rates charged for it are very high specially where there is no competition amongst the banks, and they should be lowered.

✓ FUTURE

The future of the joint stock banks in this country is dependent upon the policy of the Government to be follow-

ed in connection with various post-war schemes, both official and non-official. People in general are, however, very pessimistic. They have seen that during the period that set in after the World War I, a deflationary policy had been adopted and this along with several others did not allow the industries and trade of the country to prosper. The result was a set-back to the banking activities as well. Hence, they are afraid this time also, and look at every bank or office that is established in their locality with suspicious eyes. Of course, all banking booms have been followed in this country in the past by banking depressions. But this may not happen this time. First of all, most of the banks that have been established during the war-period have been established with sufficient amounts of capital. We know that because of the clause (1) of the Indian Companies Amendment Act, 1936, as laid down previously in this book, no bank could be started here with less than a paid-up capital of Rs. 50,000 at least. Besides, Rule 94A of the Defence of India Rules, regarding control of capital issues, promulgated on the 17th May, 1943, has prevented the growth of unsound companies which stood little chance of survival in the post-war period. Since that date, all applications for the establishment of new banks have to obtain prior sanction of the Government of India which in its turn makes consultations with the Reserve Bank of India. Next, existing banks have also been strengthening their position during this period by making additions to their reserve funds and issuing fresh shares. Thirdly, we have got this time the watchful guidance of the Reserve Bank of India as a central banking institution of the country. The relationships between the Scheduled Banks and the Reserve Bank have become closer still during the war-period. The control of the Government over the banking system of the country has also increased in the meantime. Fourthly, as we have already seen the cash position of the banks has also much improved during the war-period. The balances maintained by the Scheduled Banks with the Reserve Bank of India are now much in excess of the statutory minimum. Non-scheduled Banks have also steadily improved the percentage of their cash balances to total liabilities as is evident from their monthly Returns

to the Reserve Bank of India. Finally, there is much scope for expansion of their business by these banks in this country and let us hope against hopes that this time the Government of India will stretch its hands towards them with a view to help rather than place obstructions in their ways.

SCOPE FOR EXPANSION

These banks have got their offices in about 1400 towns. This means that there are no branches of a modern bank in about 1100 towns. But they are not of any business importance. Hence, they may be left for the present. What is of the utmost importance these days is a consolidation of the already existing banks and offices. We know that this was done in England during the later years of the nineteenth century and the earlier years of the twentieth century. We have got in this country several hundreds of banks in comparison to only 16 in England. Smaller banks may amalgamate amongst themselves or with bigger banks. Some of the cities and towns have got an alarming number of the bank offices, *e.g.*, Calcutta, 234; Bombay, 130; Lahore, 64; Madras, 56; Delhi, 50; Dacca, 37; Trichinopoly, 35; Comibatore, 32; Amritsar and Ahmedabad, 29 each. No doubt, in certain cases the number of offices is justified when looked at the amount of business available. But in many cases this can be easily reduced by amalgamation. This will not only reduce competition, but also cut down rates of expenses to the total turn over of business. The scramble for business, the hectic opening of branches and the competition in deposit rates should in future be avoided as much in the interest of the public as in that of the banks themselves. It will certainly be advantageous to all if banks follow a policy of proper co-ordination amongst themselves rather than of a cut-throat competition. Some of the banks also, as we have seen, offer interest on demand deposits. This practice should be discouraged. Then, there are people who believe that higher rates of interest should be offered to develop deposit habit in this country. But this is also not essential. What is necessary is that the banks should inspire confidence amongst the depositors. The banking

habit has spread considerably. A number of people have deposited in Government Defence and saving certificates. They are potential bank customers. There is, therefore, considerable scope for banking development. The banks will also do well to adopt a more liberal policy in respect of loans and advances and bill discounting. As has already been observed, they can justify their existence only by financing trade and industries and not by investment in Government securities. Their investment port-folio has considerably increased during war-period. The Reserve Bank can help them by freeing them of the same gradually as they need money for financing trade and industries. But this will be possible only if the post-war industrial schemes are put into operation. They might do well to act as an intermediary between investors and industries. They should purchase the shares of an industrial concern in the first instance and then unload them to willing investors gradually. They are certainly in a position to do this. They have got sufficient amounts of working capital—specially the Imperial Bank of India and the 'Big Seven'. If we look to the Boards of Directors of these banks and of the industrial concerns, we shall find that many of them are common to both. They have thus got an insight of the working of the industries as well and shall be able to form judgment on the question of the possibility of the success of an industrial concern proposed to be established. This will also avoid the establishment of concerns with propositions having no chance of success at all. The shares and debentures of the concerns passed by the banks shall be very popular with the investors, and in case they are to be taken up by the banks themselves in the first instance, they shall later on be easily unloaded amongst the public.

DIFFICULTIES AND DEFECTS

Indian banks suffer from various difficulties and defects. These must be removed in order to bring about their progress.

(1) They are not patronised by the Government and its officials. They keep accounts mostly with Imperial Bank and foreign banks. Semi-government institutions are also required to maintain their accounts with the Imperial Bank

in many cases. The Government of the country should patronise only Indian banks, and all of them—not only the Imperial Bank.

(2) They have to face the competition of the foreign banks in important places, and thus suffer losses instead of making any profits. It is only in small towns that their business is at all lucrative. The recent tendency has been for the branches in big towns to open pay-offices in small towns with a view to compensate their losses in the former by making gains in the latter.

(3) Most of the industries and a large part of trade, specially foreign trade, is controlled by non-Indians who naturally prefer to deal with banks of their respective countries working in India.

(4) Even Indian traders and businessmen are found to be maintaining their accounts with foreign banks. This is due to the lack of patriotic feelings. In other countries such sentiments play a very important part.

(5) There is the competition of the Imperial Bank with its privileged position, formerly as the premier bank of the country and at present as an agent of the Reserve Bank of India.

(6) There is also a lack of confidence in these banks due to their repeated failures.

(7) There is the difficulty of the realisation of their money by the banks because of certain legal hindrances. There are some succession laws which give a right of the transference of property to even distant relations, and the bankers very often find that a part of the security accepted against a loan is to be shared by a person other than their debtor.

(8) Equitable mortgages—mere deposit of documents without any mortgage deeds or registration—are valid only in a limited number of places. They form the most convenient type of security both for the debtors to offer and the bankers to accept, and in their absence a good deal of inconvenience is experienced and business hampered.

(9) There being a scarcity of bills and the absence of

bank acceptances, bankers are compelled to invest a relatively large proportion of their funds in gilt-edged securities. This is not desirable. They can justify their existence only by helping trade and not by helping the Government in raising loans.

(10) Here banks are required to show their secured and un-secured loans separately in their balance sheets. Further, there are no institutions in this country like the Ceyds of England and Duns and Bradstreets of America for supplying the banks with information regarding the financial status of the borrowers. These and other causes are responsible for their not granting clean advances which play an important part in the banking systems of the Western countries.

(11) All banks conduct their business in English. Only a few recognise cheques and signatures in Indian languages. The proportion of the Indians knowing English being small, this acts as a great drawback in the development of banking habit in the country.

(12) Indian banks have been modelled on the lines of English banks. Many of them have adopted an expensive system of management. They have not combined with the efficiency of the English banks the simplicity and economy of indigenous bankers.

(13) In many cases the directorate is formed of politicians and social reformers in order to attract the ignorant public towards the banks. They are usually very busy and possess rarely the qualities required of the bank directors and hence the trouble.

(14) Indian banks have no association of their own and suffer from mutual jealousies. They have shown a lack of *esprit de corps*.

(15) The superior officers of some of the exchange banks are said often to endeavour to discredit the Indian banks in the eyes of the general public. The Central Bank of India has suffered the most on this account.

(16) There has been a great dearth of trained personnel, and there has, therefore, been of late somewhat of a scramble for trained bank staff.

SUGGESTIONS FOR IMPROVEMENT

In order to remove the above difficulties and defects, the following measures may be successfully adopted.

(1) As has already been suggested, the Government of the country should patronise only Indian banks and all of them—not only the Imperial Bank. It has placed certain restrictions on these banks on the grounds of safety. These must be accompanied by concessions, and the most important of them will be a patronage of the Government. It should make all payments by means of cheques and insist on the same being done by institutions under its control as well.

(2) Restrictions should be placed on the opening of and doing business by the foreign banks. They may not be allowed to open branches in inland towns and receive deposits beyond a certain limit. Provisions may also be made for the elimination of competition between them and the Indian banks in other spheres as well.

(3) The Imperial Bank of India with its vast resources should, instead of entering into competition with the Indian banks, take up the financing of foreign trade and industries.

(4) Equitable mortgages should be allowed in important towns, as they form the most convenient type of security both from the bankers' and borrowers' point of view.

(5) Use of bills and hundis should be made more freely with a view to make discounting more popular. This can, however, be done by adopting certain measures whose discussion will be made later on.

(6) Banks should grant more of personal loans. This can be made possible only by maintaining by the bank managers personal relations with the bazar people, and for this purpose, it is necessary that they should belong to the same locality and not be outsiders. It has often been observed that local people are in a better position to build business than the outsiders.

(7) Banks should conduct their business in the language known to their clients. This will facilitate their

dealings with them and result in larger business to be built up.

(8) They should adopt the simplicity and economy of the indigenous bankers. They may form partnership with them on 'Commandit principle' as has already been explained. They must also not be very rigid in following their rules of business. Indian banks are noted for their delay in making the payment of a cheque. It is really an ordeal of the first class for a customer to obtain the payment of a cheque from any one of them.

(9) Only persons capable of understanding banking principles and taking part in the actual conduct of the business of a bank should be included in its directorate. High sounding names should cease to have an attraction for the banks.

(10) Indian banks should form an association of their own and work in *esprit de corps*.

(11) The Reserve Bank of India should give financial assistance without any grudge to such banks as deserve it whenever they need the same. This will inspire confidence in them.

(12) Banks should take up promising university graduates and give them the necessary technical training. Some such action is essential in the best interests of sound and progressive banking. There are B. Com. graduates with Banking qualifications. They may also be of great help.

LEADING INDIAN JOINT STOCK BANKS

Central Bank of India

The Central Bank of India was established in 1911, mainly due to the untiring efforts and banking genius of Sorabji Pochkanwala in whom it found a managing director of rare abilities. His death in 1938 was really a serious blow to the Indian banking in general and the Central Bank of India in particular. This bank at present tops the list of all joint stock banks in every respect whether we take up capital and reserve, deposits, branches or any other item of business. The year 1923 was a turning point in

the bank's career. It saw the amalgamation of the Tata Industrial Bank with it which resulted in an increase of its capital and reserve liability from Rs. 80 lakhs to Rs. 268 lakhs, deposits from Rs. 14 crores to Rs. 18 crores, and the ratio of the former to the latter from 5 to 7 per cent to 17 to 18 per cent. The bank opened its first branch in Karachi in the early phase of the I Great War, and by its close the number had reached to 5. In 1934, the number of its offices was 68; in 1937, it was 89; in 1938, 101; in 1940, 132 and in 1943, 217. No Indian bank has faced as much difficulty as this. There were as many as 9 runs on this bank during the first twenty-five years of its foundation.

This bank like the Imperial Bank is represented in all the provinces of the country. The average rate of interest offered by it on time and demand deposits taken together is lower than what is paid by other leading Indian banks. Since 1921, it has been showing separately the aggregate interest paid on fixed deposits and current deposits. In the twenties, fixed deposit rates were above current deposit rates by more than 2 to 3 per cent, and in the thirties by more than 1·3 per cent to 2 per cent. With the lowering in the margin of the rates of interest, there has been an increase in the percentage of current and savings bank deposits to total deposits.

Bank of India

The Bank of India was launched in 1906, and since then it has taken quick strides. In point of resources, it holds at present the second place among the Big Five. This bank has enjoyed a remarkable immunity from runs. It has followed a very cautious policy of expansion. For about 20 years from its birth it had no branches. In 1945, its offices numbered only 28, of which as many as 5 were in Bombay, 3 in Calcutta, 4 in Ahmedabad, 2 each in Nagpur and Poona, and one each in Andhehri, Bandra, Jamashedpur, Rajkot, Amritsar, Bhuj (Kutch), Junagadh, Karachi, Madras, Palanpoveraval and Surat. It is thus a bank of mostly Bombay Presidency. It showed the courage of opening a branch outside India also at Mombasa in 1921, but the same was closed only after being in existence for two years. It has sought to maintain a comparatively large

ratio of capital and reserve to its deposit liabilities.

This bank also does not offer high rates of interest to attract deposits and its investments are also very liquid and safe. It commenced with a dividend of 5 per cent in 1907, and has gradually increased the same, the 1915 dividend being 22%.

Allahabad Bank

The Allahabad Bank is the oldest among Indian joint stock banks. It was launched in Allahabad in 1865. In 1922, the P. & O. Banking Corporation made an offer of affiliation which was accepted by its shareholders. The P. & O. paid Rs. 436 for each fully paid share of Rs. 100 which had never been quoted in the market above Rs. 365. Along with the transference of its ownership there was also a transference of its head office to Calcutta. In 1927, the Chartered Bank of India, Australia and China purchased a majority of its shares from the P. & O. and hence there was again a change in its ownership.

This bank has also followed a very cautious policy. Its first branch was opened at Cawnpore in 1888. In 1917, the total number of offices was only 12. The subsequent growth has no doubt been slightly rapid, but it does not in any way reflect upon its adverse position. In 1913, the total number of its offices was 71. The percentage of cash to deposits has also been fairly large. Besides, its investments have always been in the most liquid form, *i.e.*, in Government securities. This policy is no doubt sound from the point of view of safety, but it is not good from the point of view of giving encouragement to the trade, industry and commerce of the country.

From the point of view of resources, the bank ranks third amongst the Indian joint stock banks. It operates chiefly in the United Provinces and the Punjab. Its rate of dividend has been 16 per cent in recent years.

Punjab National Bank

The Punjab National Bank was registered in 1895, and like the Central Bank of India, it is a purely Indian managed bank. It has, all along its career, been making a slow and steady progress. In 1915, it had 184 offices in all and

most of them were concentrated in the Punjab. From the point of view of resources its position is fourth among the Indian joint stock banks. Like some other Indian banks it has had difficulties but they have all been tide away with success.

The bank does not pay very high rates of interest for attracting deposits. But its rate of earning has always been lower than that of other banks. It is due to the fact that its resources per branch are the lowest of those of the Big Five, the volume of deposits being small and the number of branches being high.

Bank of Baroda

The Bank of Baroda was established in 1909. Its first branch was opened in 1919. In 1945, it had 31 offices in all—most of them being concentrated in Kathiawar and Gujarat. It has maintained a high cash ratio—generally above 15 per cent. From the point of view of its resources, it ranks fifth amongst the Indian joint stock banks. Its rate of gross profit is also very low mostly because in the area it operates, there is an abundance of funds, and hence a keen competition for business among banks and private lenders.

Bharat Bank

The Bharat Bank was registered in 1942, and is an infant in comparison to other big joint stock banks. But its capital is the highest of any other, *i.e.*, more than Rs. 2 crores. It has also opened quite a large number of offices—216 in March, 1943 and compares very favourably with even the Central Bank of India. It has built up very high deposits as well and at present ranks sixth amongst joint stock banks. It has beaten a number of good institutions. Indian Bank and Bank of Mysore were sixth and seventh before its establishment. With this rate of progress, it might beat even some of the 'Big Five' in near future and take up their position.

United Commercial Bank

The United Commercial Bank was established in 1944. Its capital is also higher than that of any of the 'Big Five'

excepting the Central Bank of India, *i.e.*, Rs. 1 crore. It has also got a very promising future.

Indian Bank

The Indian Bank ranked sixth amongst the joint stock banks. Its place has, however, been taken by the Bharat Bank. This bank was registered in 1907. It is even now the largest bank in South India. Its Head Office is in Madras and it had in 1943 50 offices in all—most of them having been opened in the years after 1935. The bank is a Nattukotai Chetties bank in the sense that most of its shares are held by this class of people. A very high percentage of loan has also been made to this class of people. The Chetties are themselves bankers and act as intermediary between the bank and the borrowers. The bank prefers the personal security of the Chetties to that of goods, etc. This is the reason why it avoids investment in Government securities and holds a considerable proportion of funds in the form of loans, advances and bills. It has not suffered in any way for this. Other banks can take a lesson from it and employ with advantage indigenous bankers as intermediaries.

Bank of Mysore

The Bank of Mysore was launched in 1912. Though its resources always have been very large, it has been granted the privilege of being a scheduled bank only very recently, *i.e.*, in the year 1943. Prior to this, the same could not be possible, probably because it had no office in British India. The rate of dividend for the last several years has been 14 per cent.

Other Banks

There are a number of other banks which are of considerable importance, *viz.* Comilla Banking Corporation, Comilla Union Bank, Bank of Jaipur, Discount Bank of India, Exchange Bank of India and Africa, Habib Bank, Hindusthan Commercial Bank, Punjab and Sind Bank, Traders' Bank, and Union Bank.

OBLIGATIONS OF SCHEDULED BANKS

It has already been observed as to which banks can

become scheduled banks. They are required, in addition, to fulfil certain obligations. First of all, a scheduled bank is required to keep an account with the Reserve Bank of India and maintain in it a balance of at least 5 per cent of its demand and 2 per cent of its time liabilities. For this purpose, it has to intimate to the Reserve Bank the name of the banking office of the latter bank at which it desires to maintain its principal account. The scheduled banks are allowed to open accounts with the Reserve Bank at any or all places where it has its offices or branches provided the former also have their offices or branches at such places. If a scheduled bank has no office or branch at the same place as the office of the Reserve Bank at which the principal account of the bank has to be maintained, it is allowed to open an account at such office of the Reserve Bank. A scheduled bank has also to send to the Central Government and the Reserve Bank a weekly return of its position in the form prescribed by section 42(2) of the Reserve Bank Act. Where the Reserve Bank is satisfied that the furnishing of a weekly return is impracticable in the case of a particular scheduled bank by reason of the geographical position of the bank and its branches, it may require the scheduled bank to furnish a monthly return in lieu of the weekly return. This return is also required to be sent to the same office at which the principal account of the bank is maintained. In the event of failure to send the return on the prescribed day or maintain the minimum balance referred to above, a penalty is imposed. For a failure to send the return to the Central Government or the Reserve Bank, as the case may be, or to each on the prescribed day a fine of one hundred rupees for each day during which such failure continues is levied. And for a failure to maintain the prescribed minimum balance, a bank is required to pay to the Reserve Bank in respect of each day during which the default continues penal interest at a rate of three per cent above the bank rate on the amount by which it falls short of this minimum, and if on the day fixed for the next return such balance is still below the prescribed minimum as disclosed by this return the rate of penal interest is increased to a rate five per cent above the bank rate in respect of that day and each subsequent day on which the

balance held at the bank at the close of the business on that day is below the minimum. The penalties imposed for both the defaults are payable on demand which is made by the Deposit Accounts Department of the office of the Reserve Bank where the scheduled bank maintains its principal account and sends weekly returns, and in the event of a refusal by the defaulting bank to pay on such demand, action can be taken in a court of law. As some of the banks were in the habit of not maintaining the prescribed minimum balance with the Reserve Bank and preferred to pay the penal interest, by a recent amendment to the section laying down the penalty in November 1940, i.e., the Reserve Bank of India (Third Amendment) Act, 1940, the penalty for default has been made even more stringent by empowering the Reserve Bank to prohibit defaulting banks from accepting fresh deposits during the continuance of the default and by penalising directors and their officers who are knowingly and wilfully parties to a default.

THEIR PRIVILEGES

The scheduled banks have also been granted certain privileges, and the most important of these is that they can get financial accommodation in the shape of the rediscount of eligible bills or loans and advances against eligible securities from the Reserve Bank. The kind of bills which the Reserve Bank may discount and the various securities against which it may make loans and advances are mentioned in section 17 of the Reserve Bank Act, and financial accommodation can be obtained only on their basis. The lending policy of the Reserve Bank as well as the kind of accommodation which scheduled banks may obtain from the Bank have been explained in the Bank's Memorandum, dated the 7th December, 1938 on 'Discounts for and Advances to Scheduled Banks' and may be recapitulated here briefly. In conformity with the usual practice of central banks in other parts of the world and with a view to promoting the development of banking on sound lines in this country, the Reserve Bank in extending its credit to the scheduled banks has to take into consideration not only the nature of the security offered to it, but also the

- office or pay office, and at which there is an agency of the Reserve Bank, free of charge ;
- (c) other remittances to its principal account subject to a charge of $1/64\%$ and also subject to a minimum charge of Re. 1 ; and
- (d) other remittances between accounts maintained at the Reserve Bank or its agencies :
- | | | |
|-------------------|-----|----------------------------|
| Upto Rs. 5,000 | ... | $1/16\%$ (Minimum Re. 1) |
| Rs. 5,000 or over | ... | $1/32\%$ (Minimum Rs. 3-2) |
- (ii) In addition telegraphic transfers and drafts in favour of third parties are issued, subject to the limits or drawings on treasury agencies, at the following rates :
- | | | |
|----------------|-----|----------------------------|
| Upto Rs. 5,000 | ... | $1/16\%$ (Minimum Re. 1) |
| Over Rs. 5,000 | ... | $1/32\%$ (Minimum Rs. 3-2) |
- Actual telegram charges are realised in addition.

OBLIGATIONS OF NON-SCHEDULED BANKS

All banks are required to conform to the regulations contained in the Indian Companies Amendment Act, 1936. But their obligations regarding the submission of the prescribed Returns and the maintenance of the prescribed minimum cash balances with their own selves may be recapitulated here once more. As far as scheduled banks are concerned, we have already noticed them. In their case the Return is required to be submitted to the Reserve Bank of India, not to the registrar, and the minimum balances are also required to be maintained with it and not with their own selves. As regards non-scheduled banks, it may be said that those having no office in British India are immuned from these obligations. Of the non-scheduled banks operating in British India, as was observed previously, prior to 1943, there were many which escaped the provisions of the law on the plea that they did not come within the purview of the definition of a bank. But since 1943, all companies using the word 'bank' or 'banking' as a part of their name have to conform to these obligations. At the end of 1944, about 613 non-scheduled banks submitted such Returns. Upto the beginning of the year 1938, they sub-

Since 15th February, 1945, a non-scheduled bank may also open an account with the Reserve Bank of India subject to the following terms and conditions :—

(1) It maintains a minimum balance commensurate with the volume of business transacted and in no case less than Rs. 10,000. The Reserve Bank has the right to prescribe a higher minimum if the labour involved in keeping the account is out of proportion to the balance maintained, and to close the account if the minimum is not maintained.

(2) The account is not to be treated as an ordinary current account and cheques in favour of third parties are not to be issued. It may, however, be used for remittance purposes and inter-bank transactions

TEST QUESTIONS

1. What are the provisions contained in the Indian Companies Amendment Act, 1936 and 1944 regarding banking companies ?

2. Into what classes Indian joint stock banks have been divided ? Describe in detail what you know of the scheduled banks.

3. What is the present position of the Indian joint stock banks ? Give in detail *their operations* bringing out clearly their special features.

4. Show the effects of World War II on Indian Banking. Have they been beneficial or detrimental to the same ? What do you think is its future ?

5. What are the *difficulties and defects* of Indian joint stock banks ? Give suggestions for their improvement.

6. Write a short note on some of the important Indian joint stock banks.

7. What are the obligations and privileges of the scheduled banks ?

8. In what ways the Reserve Bank of India maintains some touch with the non-scheduled banks ? What facilities does it afford to them ?

CHAPTER XVII

IMPERIAL BANK OF INDIA

The circumstances under which the Imperial Bank of India was created and the conditions under which it carried on its operations till the establishment of the Reserve Bank of India have already been dealt with in the twelfth chapter. But there are certain other matters concerning it which must be taken up at this stage, and of these the most important is the question as to why this bank was not made a full-fledged central bank and a new institution had to be created as such. Then, we shall look up to other things.

REASONS FOR WHICH THE IMPERIAL BANK WAS NOT MADE A FULL-FLEDGED CENTRAL BANK

(1) First of all, a central bank must have a broad national outlook in the absence of which it cannot be expected to look to the country's economic well-being and bring about an advancement of national banking in it. Imperial Bank of India never evidenced it. On the other hand there were illustrations cited before the Hilton-Young Commission which went to prove that it refused assistance to Indian banks even against government securities. While vast credit lines were extended by it to non-Indians, even reasonable facilities were refused to the people of this country.

(2) Indian banks had always been looked by it with competitive eyes and more as rivals rather than complementary units in the country's banking system. Under the circumstances no change of policy could be expected merely by placing upon it the responsibilities of a central bank.

(3) The large number of branches which the Imperial Bank of India had, were regarded as an unnecessary appendage to a central bank which can regulate the money market through its branches only at the most important

places. A central bank, in fact, fulfils its mission by mere existence than by actual operations. Finally, with a large number of branches its energies would have been dissipated in their management rather than in the control of the banking system of the country.

(4) The directorate and management of the bank being preponderatingly non-Indian, it could not be expected to feel the needs of the country and act in its interest specially when they were against those of their respective countries

(5) Its transformation into a central bank "would have necessitated far-reaching changes to be made in its working and its shareholders might not have liked these. Under the circumstances, bitter feelings would have arisen between them and the state, and the beginning of the career of a central bank with such unfortunate events would have been extremely undesirable.

(6) The Imperial Bank of India had been established with the avowed object of earning profits, while a central bank has, on occasions, to forego them in the interest of the country at large. When a boom has to be checked, a central bank has to refuse loans and raise the rate of interest, while a commercial bank would not like to do so. The opposite is the case when a depression has to be checked. There is the same difficulty with regard to the open market operations. A central bank has generally to sell off the securities during a boom period at low rates and purchase them during a depression period at high rates.

(7) Though in France, *Banque de France* combines commercial banking functions with the central banking functions, it is not possible in every country. In fact, the situation in all countries is never the same. While France has few sensitive elements in its export trade and large funds to invest abroad, India has many sensitive elements in her export trade and huge obligations to foreign investors both on private and public accounts. Under the circumstances, the Imperial Bank could not combine commercial banking functions with the central banking functions. Further, there was the question of its competition with

other banks. There was already an outcry of some banks regarding this matter against it. Had it been given the functions and status of a central bank without depriving it of its commercial banking functions, it would have become far more powerful and would have been able to offer more serious competition to them and might have even threatened the existence of some. In fact, the holder of the ultimate reserves of the country should not itself be the channel through which the credit is given to individuals and firms. Moreover, it could not have functioned as a bankers' bank also because it might have been tempted to withhold sufficient help from its rivals even if they needed and deserved it; and they far from regarding it as their saviour in their time of need would have for this reason also been always suspicious of its attitude towards them and jealous of its privileges. Further, the bank would have been suspected of managing the currency more in its own interest than those of the country. Finally, it could not have been able to perform both the commercial and central banking functions efficiently, as it would have been heavily burdened.

(8) Although it had been given the right to obtain loans upto a maximum of Rs. 12 crores from the Paper Currency Department of the Government at the bank rate subject to a minimum limit of 6 per cent for the first Rs. 4 crores and 7 per cent for the remaining 8 crores, on the security of the inland bills or hundis of an equal amount, with a view to enable it to assist the money market in the busy season, it could not be at all successful in preventing the very wide range of seasonal fluctuations in the interest rates and the very high levels which they reached in certain times of the year. 'The retention of the ultimate control of currency in the hands of the government and the peculiar arrangement by which aid from currency reserves was made dependent on particular levels of the bank rate were, no doubt, aggravating factors in the situation.' Still, it cannot be doubted that it lay in the power of the Imperial Bank to moderate the range of fluctuations but it preferred its own profits to national interests and exploited to the full the highly seasonal demand for currency. This is only one of the instances. Truly speaking, it failed to act as a central bank in various spheres it had been given power

to act as such.

THE APPREHENDED CONSEQUENCES OF THE DEPRIVATION OF ITS COMMERCIAL BANKING FUNCTIONS

From the above discussion it has become clear that much of the position would have been improved by the deprivation of its commercial banking functions. But it could not be done as certain dire consequences were apprehended. These were as follows. —

(1) There are many places where Imperial Bank is the only bank doing commercial business. These would have been deprived of their banking facilities.

(2) In many places where there are also the branches of other banks, its cessation of taking up commercial banking functions would have given them its monopoly. This would have resulted in a loss to the people in general.

(3) The Imperial Bank has inspired confidence in the public and many persons have deposited their money with it. They would have been compelled to withdraw at least what they had deposited in fixed deposit accounts with it as it could not have been allowed to continue receiving deposits in fixed deposit accounts because the same would have meant allowing it to compete with other banks. The Reserve Bank of India has also not been allowed to receive deposits on interest with this very view. Acceptance of deposits on interest presupposes profitable investment and hence the risk which a central bank cannot undertake keeping in view its position. Most of the deposits in current accounts would have also been withdrawn as they are kept with a view to obtain other banking facilities and these would not have been available, had the bank ceased to carry on commercial banking functions. The situation would have been aggravated, had it been decided to close most of its branches, as they are regarded to be an unnecessary appendage to a central bank. Many of the persons compelled to withdraw their money from the Imperial Bank would not have liked to invest it anywhere else and might have converted the same into hoards.

(4) The Imperial Bank of India has raised the standard of commercial banking by its own working. If left to

themselves, other banks might have lowered it down. This would have been quite detrimental to the interests of the country.

THE 1934 IMPERIAL BANK AMENDMENT ACT

The Imperial Bank of India was not made a full-fledged central bank and a new institution *viz.*, the Reserve Bank of India had to be raised. This necessitated certain changes in the working of the Imperial Bank and these were brought about by the 1934 Imperial Bank Amendment Act. As a result of the same, it has become a fully commercialised bank freed from certain restrictions on its business. As was pointed out in Chapter XII, the Imperial Bank Act had laid down the business that it could and could not undertake. The 1934 Imperial Bank Amendment Act could not surely remove all the restrictions on its business as its position is still required to be safeguarded and specially because it has become the sole agent of the Reserve Bank in places where it has its branches and the Reserve Bank has no office of its own. The aforesaid Act contains the provisions allowing it the following :

(1) *Conducting of any business in its London office.* Previous to this, it could not open accounts for persons who, within three years, were not either its customers in India or those of the Presidency Banks.

(2) *Opening of branches outside India in London and elsewhere.* Previous to this as has already been observed it had a branch in London only and could not have it in any other place.

(3) *Conducting of banking business in the country itself more freely than till that time.* It can now grant loan or cash credits on the shares of the Reserve Bank, on the debentures issued under the authority of municipal board or committee, or rulers of native states with the sanction of the Governor-General-in-Council, or of limited liability companies ; and on goods hypothecated to it as security on the authority of the Central Board by its special directions instead of only on goods actually in its possession. All these things were not previously allowed. Again, the period allowed for loans meant to finance seasonal agricultural opera-

tions has also since then been extended to nine months instead of to six months for all loans as previously. Finally, holding of immovable property as security for any loan or advances has also been since then allowed in certain cases.

(4) *Borrowing of money outside India for conducting its business* This was also not allowed previously.

The control of the Government has also been since then loosened. The Governor-General-in-Council now appoints only two non-officials as directors, and one officer as a member of the Central Board without any power to vote. Regulation 54 of the old Act of 1920 has also been repealed and this means that the Governor-General-in-Council has now no power to issue instructions to it regarding any matter, or call for any information, or insist on the publication of its assets and liabilities in whatever form he desires. He can, however, appoint auditors to examine and report on the affairs of the bank even now in case of necessity.

THE EXECUTIVE OF THE IMPERIAL BANK

To safeguard regional interests and give the bank a large freedom in banking, it has got three local offices at the headquarters of the three Presidency Banks. Each local office has got a local board elected separately by the shareholders whose names stand on the registers of their respective areas. The local board consists of one president, one vice-president, one secretary, one treasurer, and not less than three members. Subject to the bye-laws made by the Central Board, it has the power generally to transact all the usual business of the bank, and as regards entries in the branch registers, respectively kept at the local offices, the power to examine and pass or refuse to pass transfers and transmissions and to approve or refuse to approve transfers of shares and to give certificates of shares.

Then, there is a Central Board consisting of the following as directors :—

(1) the presidents, vice-presidents and secretaries of the local boards ;

(2) one person elected from amongst themselves by the members of each local board ;

(3) a managing director appointed by the Central Board for a period not exceeding five years on such terms as it directs, and eligible for re-appointment by it for such further periods not exceeding five years in each case as it thinks fit ;

(4) such number of persons not exceeding two and not being officers of the Government as are nominated by the Governor-General-in-Council. They hold office for one year but are eligible for re-nomination ;

(5) a deputy managing director appointed by the Central Board ;

(6) an officer of the Government nominated by the Governor-General-in-Council.

The directors specified in (5) and secretaries specified in (1) and the officer specified in (6) are at liberty to attend all meetings of the Central Board and to take part in the deliberations, but they are not entitled to vote on any question arising at the meeting ; provided that the deputy managing director is entitled to vote in the absence of the managing director.

The function of the Central Board is to supervise generally the affair and business of the bank and to exercise all powers and do all such acts and things as may be exercised or done by the bank and are not by the Act expressly directed or required to be done by it in general meetings. For its guidance and that of the local boards, it has made a number of bye-laws concerning important matters.

There are the provisions also for holding annual general meetings and special meetings of all the shareholders or only those enlisted on a branch register to pass the accounts or transact such business as may be placed before them.

BUSINESS WHICH THE BANK IS AUTHORISED TO TRANSACT

The bank is authorised to transact the following business :—

(1) to advance money and open cash credit upon the security of (a) stocks, funds and trustee securities including those of a Local Government or the Government of Ceylon and shares of the Reserve Bank of India ; (b) securities of the state-aided railways sanctioned by the Governor-General-in-Council for investment, (c) debentures, etc., issued under the authority of any Act of a legislature established in British India, or on behalf of a district board, or a municipal board or committee, or debentures, etc. issued on the authority of a Prince or Chief of any State in India sanctioned by the Governor-General-in-Council, or of limited liability companies subject to the directions issued by the Central Board, (d) goods pledged with, or hypothecated to it under the authority of the Central Board by its special directions, or the documents of title to them deposited or assigned with it, (e) accepted bills and promissory notes endorsed by the payees and joint and several promissory notes of two or more persons or firms unconnected with each other in general partnership, and (f) fully paid shares of limited liability companies or immovable property or documents of title relating thereto as collateral security where the original security is one of those specified in (a) to (d) and subject to the directions issued by the Central Board where the original security is of the kind specified in (e). In the case of advances to the Secretary of State, however, no security is needed if the Central Board so thinks.

(2) to sell and realise proceeds of such sales of promissory notes, debentures, stock receipts, bonds, annuities, stock, shares, securities or goods or documents of title thereto as might have become bank's, in lieu of the default of payment of loans in connection with which they might have been deposited.

(3) to advance money to Court of Wards upon the security of the estates in their charge or under their superintendence and realise it along with interest. Such advances are, however, to be made with the previous sanction of the local government concerned and for not more than nine months for the purposes of financing second agricultural operations and not more than six

months in other cases.

(4) to draw, accept, discount, buy and sell bills of exchange and other negotiable securities ;

(5) to invest funds of the bank on securities specified in from (a) to (c) of (1) and convert them into money, and alter, convert and transport them for or into others of the investments specified in (1) ;

(6) to make, issue and circulate bank post bills, letters of credit to order or otherwise than to the bearer on demand ;

(7) to buy and sell gold and silver whether coined or uncoined ;

(8) to receive deposits and keep cash accounts on various terms ;

(9) to accept charge of plate, jewels, title deeds or other valuable goods on various terms ;

(10) to sell and realise all property both movable and immovable, coming in the bank's possession, and acquire and hold, and generally deal with any right, title or interest in any property movable or immovable coming in its possession ;

(11) to transact pecuniary agency business on commission and enter into contracts of indemnity, suretyship or guarantee with specific security or otherwise ;

(12) to administer estates for any purpose whether as an executor, trustee or otherwise and act as agent on commission to buy, sell, transfer and take charge of any securities or any shares in any public company : to receive proceeds whether principal, interest or dividends of any securities or shares ; and to remit such proceeds by public or private bills of exchange, payable either in India or elsewhere ;

(13) to draw bills of exchange and grant letters of credit payable out of India ;

(14) to buy bills of exchange payable out of India at any usance not exceeding nine months in the case of those relating to the financing of seasonal agricultural

operations or six months in other cases ;

(15) to borrow money for the purposes of the bank's business and give security for it by pledging assets or otherwise ;

(16) to subsidize from time to time pension funds of the Presidency Banks ; and

(17) generally do all such matters and things as may be incidental or subsidiary to the transacting of business mentioned above.

BUSINESS WHICH THE BANK IS NOT AUTHORISED TO TRANSACTION

The bank cannot transact any business other than those specified above and in particular the following :—

(1) making of any loan for a longer period than six months or nine months as in (3) and (14), on the security of its own stock or shares, or on that of mortgage or otherwise of any immovable property or the documents of title relating thereto except as specified in (3) ;

(2) discounting of bills for and advancing money to any individual or partnership firm for an amount exceeding in the whole at any one time the prescribed sum save upon a security mentioned in (a) to (d) of (1) ;

(3) discounting or buying, or advancing and lending, or opening cash credits on the security of any negotiable instrument of any individual or partnership firm payable in the town or at the place where it is presented for discount which does not carry on it the several responsibilities of at least two persons or firms unconnected with each other in general partnership ; and

(4) discounting or buying, or advancing and lending, or opening cash credits on the security of negotiable security which is not eligible for the investment of trust funds or which falls due if drawn for the purpose of financing seasonal agricultural operations after more than nine months and if drawn for other purposes after more than six months from the date of the proposed transaction.

AGREEMENT OF THE RESERVE BANK WITH THE IMPERIAL BANK

Section 45 of the Reserve Bank of India Act laid down for an agreement between the Reserve Bank and the Imperial Bank and the Third Schedule thereto contained provisions for incorporation in it. This was entered into and signed by both the parties on its approval by the Governor-General-in-Council. Under it, the Imperial Bank has become the sole agent of the Reserve Bank at all places in British India where there is a branch of it and not of the Banking Department of the Reserve Bank. In consideration of the performance by it, on behalf of the Reserve Bank, of the functions which it had been performing on behalf of the Governor-General-in-Council at these places, the Reserve Bank has to pay it a commission on the total of the receipts and payments dealt with annually by it on that account. In the beginning, for the first ten years, it was at $1/16$ per cent for the first Rs. 250 crores and at $1/32$ per cent for the remaining sum. After the expiry of this period the remuneration to be paid for every next five years was to be determined after examining the cost to the Imperial Bank of performing these functions, and hence this has been done very recently. The revised commission rates are on the first Rs. 150 crores at $1/16$ of 1%; on the next Rs. 150 crores over Rs. 150 crores at $1/32$ of 1%; on the next 300 crores over 300 crores at $1/64$ of 1%; and on the remainder at $1/128$ of 1%. Further, there was also a provision for the payment, to the Imperial Bank by the Reserve Bank for the former's keeping open branches not less in number than those at the commencement of the Reserve Bank Act, of Rs. 9 lakhs per annum during the first five years, of Rs. 6 lakhs per annum during the next five years, and of Rs. 4 lakhs per annum during the subsequent five years. The Imperial Bank cannot open any branch in substitution of a branch existing at the time at which the agreement came into force without the approval of the Reserve Bank. The Reserve Bank is, however, free to open its own offices at any place, notwithstanding the fact that the Imperial Bank has up till then acted as its agent at those places.

The agreement is to run for 15 years and thereafter until termination after 5 years' notice on either side. It is conditional on the Imperial Bank's maintaining a sound financial position. If in the opinion of the Central Board of the Reserve Bank, the Imperial Bank at any time fails to do this or to fulfil the condition of the agreement, it is permitted to approach the Governor-General-in-Council who is authorised to issue instructions to the Imperial Bank with reference to the agreement or to any matter involving the security of Government money or the assets of the Issue Department of the Reserve Bank with it, and on the disobedience of the same by it, he has the power to terminate the agreement.

ADVANTAGES DERIVED FROM ITS ESTABLISHMENT

A number of advantages have been derived from the establishment of the Imperial Bank of India. These may be given here as under :—

(1) When the Presidency Banks were amalgamated into the Imperial Bank, they had altogether 59 branches between them. Under the agreement entered into between the Imperial Bank and the Secretary of State for India, the former was required to open 100 new branches within a period of 5 years from the date of its commencement. By March 1926, this obligation had been fulfilled and 102 new branches had been opened till that time. At the end of 1945, however, it had more than 400 offices. There were many places which had no office of any modern bank at the time of its opening an office. No doubt, in some of them, offices of other banks have been opened since then. But there are still more than 100 places which have got only an office of the Imperial Bank. This means that these places have received banking advantage only because of the Imperial Bank.

(2) It has inspired confidence in the public. There had been numerous failures of joint stock banks, and people had no confidence left in them. Imperial Bank was, till 1934, a Government bank, and they knew that it could not fail. Even now, it has got a unique position because of its being a sole agency of the Reserve Bank, the pre-

mier bank of the country. As a result of this, money was and continue to be deposited with it.' The bank, by coming to assistance of the joint stock banks at different times when runs were made on them also prevented their failures. This had the further effect of inspiring confidence of the public in them also. Due to this, deposits with Imperial Bank and also with the joint stock banks have appreciably increased. Opening of new branches by it has also led to the conversion of the hoards in those places into bank deposits if not to the fullest extent to some extent. It can thus safely be said that the Imperial Bank has done a service to the country by mobilising its capital.

(3) The places where the bank has opened its branches have also received the benefits of its advances. Not only this, but the rate of interest in them has also been appreciably reduced. In addition to this, the rate of interest in places where there is no branch of the bank has also gone down due to the fear of the bank being induced to open its branch there. This has not been done by only indigenous bankers; but joint stock banks too have done so. As the Imperial Bank had previously the Government balances with it, the funds that it could employ in this way were sufficiently huge. It had also been given, as we know, the power of getting emergency currency issued to the extent of Rs 12 crores. This had the effect of steadying the high rate of discount that prevailed during the busy season.

(4) Because of a very large number of its branches, it could give more of remittance facilities also. Not only did this bank give the increased remittance facilities but the joint stock banks too were enabled to do this. The commission charged for rendering this service was also sufficiently reduced.

(5) It was also expected that the bank would be able to increase the use of bills, by giving rediscounting facilities. This was, however, not accomplished, as the joint stock banks did not like to disclose their bill portfolios to one, in competition with them. However, the bank finances the movement of a large proportion of crops by means of

advances against stocks, the discounting of bills, and the purchase and sale of demand drafts and telegraphic transfers. The bank has also succeeded in reducing the difference between its own hundi rate and the bazar rate. It has also reduced to some extent the variations in the rates of the Bombay, Calcutta and Madras markets.

(6) It has also built up close relations with the provincial and district co-operative banks and allows them overdrafts, etc

(7) The bank established clearing centres at its important branches and thus provided to other banks this facility for the first time in the country. The number of cheques cleared increased every year.

(8) The Imperial Bank floated and managed the public debt through its numerous branches and thus made the Government securities available more freely to the public.

(9) It has been able to secure to its customers the advantages of its being in touch with the most important of the international money markets as it has got a London branch.

EFFECTS OF THE ESTABLISHMENT OF THE RESERVE BANK UPON ITS USEFULNESS

The usefulness of the Imperial Bank has not at all been affected by the establishment of the Reserve Bank. As has already been observed, it continues to inspire the same confidence in the public as in the past. As it has been freed from certain restrictions on its business, its usefulness to the public has, truly speaking, increased. Now it can grant loans for a longer period and against securities of various kinds. It can also take up exchange business now.

IMPERIAL BANK AND THE GENERAL PUBLIC

From the above, it is obvious that the Imperial Bank of India has been of great use to the general public, its customers, joint stock banks, co-operative banks and Government. First of all, there is the general public. It has been benefited by the popularising of the banking

business. We have already seen how by opening new branches and by being a Government bank and since the establishment of the Reserve Bank of India by being its sole agent and finally by coming to the assistance of the joint stock banks, it has inspired confidence among the public and inculcated the banking habit gradually. Besides, the staffing of its innumerable branches has required men trained in the methods of banking and this has stimulated very considerably the training and employment of Indians as bankers. Thus, a banking career has been created in the country, and this has surely relieved other crowded careers though to only a very small extent.

IMPERIAL BANK AND ITS CUSTOMERS

With the utilisation of the Government balances, it was able to give to its customers the benefits of the low rates of discount and interest. Further, by calling for an increased volume of currency from the Currency Department of the Government during the busy season, it bridged the gap between the discount rates between the busy and slack seasons. Then, it has a London branch. Its first advantage has been the establishment of a close relation of the bank and through it of its customers with the most important of the international money markets. Secondly, it obtains trustworthy information regarding English traders and hands it over to those of Indian customers who wish to enter into business relations with them. Thirdly, it secures sterling loans for local bodies, and effects the investments of the money of its Indian customers in international securities. Finally, with its numerous branches, it gives greater banking facilities to its customers.

IMPERIAL BANK AND JOINT STOCK BANKS

The Imperial Bank of India was expected to be the guide, friend and philosopher of the joint stock banks rediscounting their bills and satisfying their needs for credit. But it failed utterly in this respect. Being in competition with the joint stock banks it could not inspire confidence amongst them and this was the most needed to enable it to perform the functions mentioned above. The

joint stock banks did not rediscount their bills with it for the fear of disclosing the names of their customers to their rival. They also avoided to obtain credit from it lest the public might know it and become suspicious of their position. In certain cases, it was charged with a policy of discrimination in favour of the European managed banks as against those managed by Indians. There are, however, instances of the assistance rendered by the Imperial Bank to the joint stock banks and to that extent it surely prevented their falling into misfortune. It undertook to repay 50 per cent of deposits including current accounts and savings bank deposits of the Alliance Bank of Simla immediately on the suspension of its payments and thus prevented the ruin of many. The bank has also been advantageous to them in other ways. As already pointed out, it gave them remittance and clearing facilities. Besides, it set before them by the example of its own working an ideal which at least some of them could successfully achieve.

IMPERIAL BANK AND THE CO-OPERATIVE BANKS

As already pointed out the co-operative banks got accommodation from the Imperial Bank which grants them overdraft and advances in various other forms. It has maintained very good relations with them.

IMPERIAL BANK AND THE GOVERNMENT

With the signing of the agreement between the Imperial Bank and the Secretary of State for India, the Government abolished its reserve treasuries wherever the former had its offices. And as we already know these went on increasing. With every increase in the number of the branches of the bank, there was a corresponding abolition of the reserve treasuries of the government. This has, as can well be imagined, resulted in a huge saving of the establishment expenses of the government. Next, the Government was saved of the trouble of issuing currency transfers to the public between any two places in which a local head office or branch of the bank was situated. Its funds were made

available by the bank at whatever places they were needed. Finally, as it floated and managed the public debt, its administration was greatly improved. The small investors began to go more freely for Government securities than it used to be the case formerly.

IMPERIAL BANK AND FOREIGN BANKS

It may be said that the establishment of the Imperial Bank has not in any way resulted in disadvantage to the foreign banks. Before the passing of the Amendment Act of 1914, as we know, it could not undertake exchange business and hence there was no fear of its offering any competition to them. Since the passing of the above Act also though it has been allowed to carry on this business, it has not undertaken it so far. As against this, it may be said that there has always been maintained a very cordial relation between the officers of both the banks.

AN ESTIMATE OF THE POSITION AND THE BUSINESS OF THE IMPERIAL BANK

The Imperial Bank has been enjoying a very proud and privileged position since its establishment. Till 1931, it was a government bank and a bankers' bank and since then it has been the sole agent of the premier bank of the country, viz., the Reserve Bank. This has led to the creation of a sense of security and confidence in the minds of the public with regard to it, and this fact is, in fact, more responsible for the huge amount of deposits it has been able to accumulate than any other. From the point of view of the number of offices 402 in 1944, the amount of capital (Rs. 5,62,50,000), reserve fund (Rs. 5,62,50,000), deposits (Rs. 242,88 lakhs) and what not, it is the biggest bank in the country—even bigger than the premier bank itself. Even if we take up all the banks belonging to a particular group together, as is evident from the following it stands in a better position than some of them.

A comparative position of the several classes of banks as at the end of 1944 in respect of their paid-up capital and reserves, deposits, cash balances, investments and loans and advances in relation to their deposits has been given on the next page. —

IN LAKHS OF RUPEES

Group	Year	No of reporting banks	Paid-up capital and reserves	Deposits	Cash Balances	Percentage of cash to deposits	Investments	Percentage of investments to deposits	Loans and advances and bills discounted	Percentage of loans and advances to deposits
1. Scheduled Banks.										
(a) Imperial Bank	1913	1	11.18	214.53	53.36	24.9	130.20	60.7	40.60	18.9
(b) Exchange Banks	1913	16	..	110.19	17.21	12.8	..	..	..	..
(c) Other scheduled Banks	1913	68	23.66	319.65	76.56	21.2	161.25	51.4	107.12	33.6
2. Non-Scheduled Banks										
(a) Banks having a paid-up capital and reserve over Rs. 5 lakhs	1913	35	2.80	19.33	6.36	32.9	5.38	26.8	9.91	51.3
(b) Banks having a paid-up capital and reserve between Rs. 1 lakh and Rs. 5 lakhs	1913	152	3.16	20.59	6.69	32.0	4.75	22.7	12.53	59.9
(c) Banks having paid-up capital and reserve between Rs. 50,000 and Rs. 1 lakh	1913	141	98	6.26	1.97	31.5	1.05	16.8	4.12	65.8
(d) Banks having paid-up capital and reserve below Rs. 50,000	1913	133	23	75	13	17.3	6	8.0	69	92.0
3. Co-operative Banks.										
(a) Banks having paid-up capital and reserve of Rs. 5 lakhs and over	1913	12	6.08	29.75	3.51	11.8	..	..	17.17	57.7
(b) Banks having paid up capital and reserve between Rs. 1 lakh and Rs. 5 lakhs	1913	295	6.13	18.20	2.82	15.6	..	..	18.54	74.4

With its vast resources, the bank is regarded to be a formidable rival by the Indian joint stock banks. It has been the most aggressive and has broken their monopoly in many places. It has entered even the mandis and competes with the joint stock banks in the financing of agricultural trade. Previously it granted loans for six months only but as we already know they have now been extended to a period of nine months. It grants loans now on the basis of all kinds of securities—goods, immovable property, documents of title to them, securities, etc. The rate of interest charged by it is also lower than that charged by other banks.

It has also now been allowed to deal in foreign exchanges. But this business has so far been not taken up by it, and hence there is no competition between it and the exchange banks. It is in a position to compete with them very successfully.

The bank is managed mostly by non-Indians. It has failed to employ Indians on responsible posts. This has resulted not only in making its expenditure top-heavy, but also in bringing it into disrepute in the eyes of the Indian people. It is, however, as already stated very popular with them in view of the confidence it has succeeded in inspiring in them.

FUTURE POLICY OF THE IMPERIAL BANK

The future policy of the Imperial Bank should be to fall in line with the national sentiments. Its officers must pay special attention to the removal of the suspicion from the public mind that they resort to racial and political discrimination. The situation may be improved by Indianising the higher staff. This will help it in building up more business, because of the greater touch that these people shall be able to maintain with the public in general. It will also result in economy in the establishment charges. The bank must also encourage the use of the Indian languages. It should also avoid unhealthy competition with Indian joint stocks. There are various other businesses which it may undertake. First of all, now when it has been allowed to deal in foreign exchanges, it must

take up this business. As will be seen later on, the foreign banks which monopolise at present in this business do not act in the interest of this country. They favour the businessmen of their respective countries, and always keep in mind interests of their own nationals rather than those of the Indians. There is a pressing need of some Indian banks which may break up their monopoly; and no other bank in the country excepting the 'Imperial' with its vast resources is capable of doing so. The bank may also take greater interest in providing assistance to industries. It can well fill up the gap in the Indian banking system in that sphere.

Even as it is, the bank can do a lot. First of all, it can remove the scarcity of commercial bills by pursuing a liberal policy in rediscounting the bills of indigenous bankers. This can also be done by discriminating between the discounting rate and the interest rate for loans against first class securities. The former should be a little lower than the latter. Secondly, it should show a greater consideration to the indigenous bankers. They may be relied upon for the collection of bills and cheques in the same way as the joint stock and co-operative banks are relied upon. It may form with them a partnership in places where it thinks it cannot have a whole time office due to the paucity of business on 'Commandit principles' on the lines recommended for the joint stock banks.

TEST QUESTIONS

1. What are the reasons for which Imperial Bank was not made a full-fledged central bank? In this connection also mention the apprehended consequences of the deprivation of its commercial banking functions.

2. What changes have been brought about by the Imperial Bank Amendment Act in the kinds of business the Imperial Bank may undertake, the constitution of its managing body, and the power of the intervention in its affairs by the Governor-General-in-Council?

3. What is the present constitution of the Central Board of the Imperial Bank? Mention also what you know of its Local Boards.

4. What are the businesses which the Imperial Bank can now undertake, and what are those which it is still prohibited to do?

5. What are the provisions contained in the agreement entered into between the Imperial Bank and the Reserve Bank? What have you to say in this connection?

6. What advantages have been derived from the establishment of the Imperial Bank? What in your opinion have been the effects of the establishment of the Reserve Bank upon its usefulness?

7. Of what use has the Imperial Bank been to the general public, its customers, joint stock banks, co-operative banks, Government, and foreign banks?

8. Give estimate of the present position of the Imperial Bank. What in your opinion should be its policy in future?

CHAPTER XVIII

EXCHANGE BANKS

Exchange banks are the banks with their head offices abroad. Though the epithet to them suggests that they undertake only exchange business, this is not so. Besides doing this business, they conduct ordinary banking business as well, i.e., they lend money at call, make investments, grant loans, issue commercial and travellers' letters of credit, receive deposits and do agency business. But they specialise in purchasing and discounting foreign bills and supplying foreign exchanges, and it is this special feature that differentiates them from the other banking institutions of this country. The financing of the foreign trade of India is practically in their hands. Really speaking, the fact that the Presidency Banks were not allowed to deal in foreign exchange business gave scope for these banks to specialise in it. Even the Imperial Bank was not allowed to undertake it till 1934. At present also, as we already know, it does not undertake it to any appreciable extent. As far as Indian joint stock banks are concerned, none of them was, till a few years back, in such a sound position as to take up this business. Exchange business can only be undertaken by an institution if it has got vast resources. No doubt, some of the Indian joint stock banks do now command them, but there is the question of early start. The foreign banks doing this business have been doing it for long and cannot let any other institution intrude on it. The Central Bank of India undertook this business some years back but it was probably due to this reason that it could not make much headway. The circumstances under which the exchange banks were established here in India, and the progress they have made since then are already known to us. It now remains only to examine their present position, methods of business, and suggestions for the removal of defects, if any.

PRESENT POSITION

As already stated, the number of the foreign banks working in this country in the year 1945 was only 16. They had 80 offices in all. The most aggressive were Llyods

Bank with 17 offices, Grindlay & Co., with 14 offices, National Bank of India with 11 offices, Chartered Bank of India, Australia and China with 9 offices, Mercantile Bank of India with 7 offices. Besides, the Chartered Bank of India, Australia and China with its association with the Allahabad Bank which had in that year 71 offices usurped this business in many other places.

As these banks do not publish separate balance sheets for their business in India and Burma nothing can be said with regard to their capital and reserve fund. Their deposits compare very favourably with those of the Indian joint stock banks and the Imperial Bank. The foreign banks pay interest on demand deposits also, and this compels the Indian joint stock banks as well to do so. They are responsible for a higher rate of interest also.

Their percentage of cash to deposits was 19·3. This is very low in comparison with that of the other banks—Imperial Bank 25·9 and Scheduled Banks (only Indian joint stock bank) 23·6.

No figure of their investments is available in India and Burma, and hence nothing can be said on this score.

THE METHODS OF THEIR BUSINESS

Under this heading we have to consider only the methods of financing India's foreign trade, as the methods of doing other kinds of business do not vary from what are adopted by the Imperial Bank and other commercial banks of the country. This work usually consists of two operations, *viz.*, (1) the financing from the Indian port to the foreign port or *vice versa*, and (2) the financing from or to the Indian port, to or from, the upcountry distributing or collecting centres. The whole of the first kind of business and in some cases the second kind of business also is in the hands of these banks. As already seen, they have got a number of branches in the inland towns and are associated with one or more of the Indian joint stock banks. It is through them that they perform the second class of business.

Trade accounts between India and foreign countries are settled through bills. When goods are exported from

this country, a D/A or D/P bill is drawn on the foreign importer or on some firm of an accepting house or bank in London with which the foreign importer may have opened a credit. It is either purchased by or discounted with a foreign bank doing business in India. The amount of the bills so drawn is usually in sterling and banks pay it in Indian currency according to the current rate of exchange on that particular date. Most of these bills are documentary and at ninety days' sight. However, sight bills as well as those of more than ninety days' sight are sometimes drawn. Then, most of them are D/A bills, only a small proportion being D/P. In fact, here in India, there are banks of almost every country, and they give a good reference of the nationals of their respective countries, and thus enable them to import on D/A term. In cases where the foreign importers open credit with some London firm of an accepting house or bank, there is no need of any reference, and the bills drawn are naturally D/A. Hence, it is only when good reference is not available or credit is not opened with some London firm or banker that D/P bills are drawn and such instances are certainly very rare. The rate for a three months' bill is higher than that for a sight bill, because it also includes interest for the duration of the bill at the rate prevailing at the centre on which it is drawn.

The bills purchased or discounted by the foreign banks are sent to the importer or the office of the firm or bank with which a credit has been opened and accepted. After the endorsement of the holding bank, they can be discounted in the open market, thus enabling the holding bank to receive in sterling whose equivalent had been paid by it in rupees in India. The holding banks may also keep the bills till maturity, if they do not require funds immediately, or have no chance of employing them more profitably.

Coming to imports, they are also financed in two ways. The first is generally used in connection with imports by Indians, and those foreigners who fail to provide a good reference or to open a credit with some London firm of an accepting house or bank. It consists of the foreign ex-

porters' drawing 60 days' sight D/P bills on importers in this country and discounting them with their respective banks doing business in India. The discounting banks also receive letters of request and hypothecation from the exporters in their favour and thus become holders of value for bills. They, then, present them to the importers who accept them but do not receive documents attached thereto, as these cannot be delivered before their payment under the terms. But as without securing them, delivery of the consignments cannot be obtained and any delay in doing it entails a heavy loss arising out of the demurrage required to be paid for not clearing them, the importers apply to the banks which deliver them shipping documents on the condition of the consignments released on their basis being held by them in the form of trust and obtain from them trust receipts.

The other method is generally used in connection with the imports by non-Indians. It is very rarely that good references are supplied of Indians and they are enabled to open a credit with some London firm of an accepting house or bank. In such cases it is used in connection with the imports by Indians as well. Under it, the foreign exporter draws a bill on the firm or bank with which the credit has been opened. It may be with the exchange bank itself. An advice to this effect is given at the time of the sending of the indent to the foreign exporter. The drawee firm or the bank accepts the bill on receipt of the documents and sends them for delivery to the importer. The exporter is now in a position to discount it in the discount market. The importer places the accepting firm or bank with funds a few days before the date of the maturity of the bill accepted by him on his behalf.

The import bills are also generally drawn in sterling. In case, they are drawn on importers in this country, interest is charged from the date of the drawing of the bills to the approximate date of the arrival of their proceeds in the exporters' country. In case they are drawn on a London firm of an accepting house or banker they are discounted in the London market at the prevailing rate of discount which is always lower than the rate

of interest charged on the former class of bills. Discount is charged on these bills only for the period they have to run. Non-Indian importers in India and some of the Indian importers who are enabled to open credit with a London firm of an accepting house or bank get an advantage over other competitors who are financed in the former way. It may also be pointed out that in case an Indian importer is enabled to open credit with a London firm of an accepting house or bank, he is required to deposit at least 15 to 20 per cent of the aggregate amount at the time of the opening of such a credit, while the non-Indian importer is not required to do so. From this, it is evident that Indian importers suffer from serious drawbacks while non-Indian importers in this country are always placed at an advantage over them.

As has been observed, almost all our import and export bills are drawn in sterling. It is only in connection with our trade with China and Japan that they are drawn in other currencies.* In the former cases, it is in rupees, and in the latter in yens.

India has normally a favourable balance of trade, and hence exchange banks have a surplus of sterling. This surplus is purchased by the Reserve Bank of India which has to meet the home charges on behalf of the Government of India. In case any surplus is left with it even after meeting the home charges, it is invested by it in sterling securities on whose basis notes can be issued in this country. If there is an unfavourable balance of trade in any particular year, the exchange banks can purchase the sterling from the Reserve Bank which supplies the same by realising the sterling securities. It may be noted that the Reserve Bank of India is bound by its statutes to purchase and sell sterling at fixed rates in sums of not less than £10,000.

DEFECTS IN THE FINANCING OF FOREIGN TRADE BY FOREIGN BANKS

The defects in the financing of our foreign trade by foreign banks are obvious.

*This was before World War II. What will be done in future is to be seen.

(1) Our export and import bills, both are drawn mostly in sterling. This makes it necessary that they should be rediscounted in London money market. Introduction of rupee bills will go a good deal forward to encourage the development of a bill market in this country.

(2) Indian importers have to import largely on D/P terms. This is due to the exchange banks not supplying good references of them. We already know its disadvantage to them.

(3) Even those Indian importers who are enabled to open credit with a London firm of an accepting house and are thus enabled to have the advantage of D/A terms, are required to deposit with the exchange banks 15 to 20 per cent. of the aggregate amount in advance. It is not required of non-Indian importers.

(4) While in the case of non-Indians, the documents attached to the import bills are sent to their offices for examination, in the case of Indians it is not so done. They are called to the banks' offices for this purpose.

(5) The foreign banks compel the importers to utilise the shipping services of their own nationality.

(6) They also insist on insurance with foreign insurance companies.

(7) They charge a penalty for the late completion of exchange contracts. It has already been observed that they obtain trust receipts from the Indian importers before releasing the documents attached to D/P bills.

There are some more disadvantages of the foreign banks' doing business here in India.

(1) They have not appointed Indians on responsible posts though they have been working in this country for long.

(2) They are opposed to the development of exchange business by Indian banks and try to create difficulties before them.

(3) They have opened their branches in the interior of the country also and thus compete with Indian banks in

other spheres too.

(4) They acquire shares in Indian joint stock banks and thus use them to their own advantage.

(5) They oppose the constitutional reforms in this country on the plea of danger to their special interests.

THE QUESTION OF LICENSING AND RESTRICTING EXCHANGE BANKS

As a result of the above complaints against exchange banks the question of licensing and restricting them has several times been discussed. The Central Banking Enquiry Committee recommended the abandonment of the open door policy with regard to them. Germany, Italy, Japan, Canada and several others have a system of licensing foreign banks. Now that the Reserve Bank of India has been established here it may become the licensing authority. In fairness to the existing foreign banks, it may be said that they should be given licenses freely for a definite period and these must be renewed provided the licensing authority is satisfied that the provisions of the Indian law applicable to them and other conditions mentioned in the license have been duly carried out. One of the conditions must be that they should make separate returns in regard to their Indian and non-Indian business. It will enable an easy ascertainment of the position of Indian interests in the aggregate interests of the banks. It has also been suggested that in case of failure of any foreign bank, the interests of Indian depositors stand in need of protection. But the contingency contemplated is only theoretical, as those institutions with their vast resources and strong position cannot be ordinarily overthrown. No doubt, there is some danger when a war breaks out. But at such times, as we know, the assets of the banks involved are not allowed to be transferred and hence there cannot arise any question of difficulty. Next, they may be prohibited from opening new branches in the interior of the country. But there is a doubt with regard to the acceptance of this condition by the Governor-General-in-Council who has got a special responsibility to safeguard the already existing British interests in the

country. In lieu of or in addition to the prohibition of opening new branches, it has sometimes been suggested that restrictions should be imposed on the aggregate deposits which these banks may raise in India. It is also proposed that no foreign bank should be permitted to obtain a controlling interest directly or indirectly in any Indian bank. This restriction is very necessary with a view to prevent them from evading the restriction regarding the opening of branches. The license should also lay down that the whole staff, except the manager and one more official in each branch, must be Indian. Finally these banks should be required to pay full income-tax on their profits earned in this country and reveal all accounts to the tax authorities to enable them to assess the tax satisfactorily.

If licensing and restricting of the business of foreign banks is not brought about, they must themselves improve their working by adopting the following methods, if they wish to create good will among the Indian people. They cannot do without it, specially in view of the awakening of the Indians and the possibility of their getting full freedom in near future.

SUGGESTIONS FOR IMPROVING THE WORKING OF FOREIGN BANKS

(1) They must give good references of the reliable Indian importers in the same way as they give of the reliable non-Indians.

(2) They must help them in opening credit with a London firm of an accepting house without compelling them to deposit 15 or 20 per cent of the aggregate amount in advance. Failing this, they must themselves accept the bills on their behalf.

(3) They should not place any impediment on the drawing of rupee bills. The bank rate of the Reserve Bank has been at 3 per cent for long and under the circumstances if rupee bills are allowed to arise, there is a possibility of the emergence of a discount market in this country.

(4) They should appoint Indians to responsible posts. This will result in the improvement of not only their business in this country but also in that of their relations with the people in general.

(5) They should work in harmony with Indian banks and give up their antagonistic attitude towards everything belonging to this country. They must also come in agreement with Indian insurance companies. There is also a possibility of the emergence of Indian shipping, and in case it comes into existence, they must support it. Their opposition to the constitutional advance of the country should also be given up.

SUGGESTIONS FOR INCREASING THE PARTICIPATION OF INDIANS IN THE HANDLING OF FOREIGN EXCHANGE BUSINESS

Whether foreign banks are licensed or bring about an improvement in their working or do not do anything, there is the need of increasing the participation of Indians in the handling of foreign exchange business. In spite of the fact that a number of British banks had been established for this purpose in this country, American, Japanese, French, Dutch and other banks were established. This is due to the reason that the extent of a nation's participation in its foreign trade depends entirely upon the banking facilities obtained by those actually engaged in it. It is but natural that the banks of a country should give better facilities to their own nationals. Germany and Japan could improve their foreign trade and the participation of their nationals in it by establishing their own banks to handle the exchange business. The Central Banking Enquiry Committee and the foreign experts both realised it and hence suggested that well-established Indian banks should open foreign connections for the benefit of their customers on the lines of the German banks.

Besides, a number of other suggestions have also been given by different authorities with the same end in view. First of all, it was suggested that Imperial Bank of India should be allowed to take up this business. The restriction caused much annoyance to a large section of

Indians. It was imposed upon the Presidency Banks with a view to avoid risk attendant to it. But since the country's adoption of the exchange standard there was no such thing and hence there was no reason for its continuance. The Imperial Bank of India was, therefore, by the Imperial Bank Amendment Act, 1934, freed to take it up. As was pointed out by its Managing Governor before the Central Banking Enquiry Committee, its staff could be trained for it in a short time. But the bank has, in spite of all this, not shown any interest in this business. There are, however, some people who say that its policy being anti-Indian there could not be any advantage to the country had it even shown interest in it. There is every possibility of its fraternising with the existing exchange banks.

The Central Banking Enquiry Committee recommended the establishment of a Government exchange bank. But this was to come in existence only if the Imperial Bank did not take up this business. Its capital was to be subscribed mainly by the Indian joint stock banks and any deficiency was to be temporarily made good by the Government. There were some members who favoured the taking up of all the shares by the Government. Besides, they were also opposed to the proposal that the Imperial Bank should be induced to develop exchange business on the ground that so long as more than one-half of its shares continued to be in the hands of non-Indians, it could not be regarded as a predominantly Indian institution. The ground for their favouring the taking up of all the shares by the Government was that the situation created by the monopoly of the exchange banks being difficult, the full resources and prestige of the state were needed to bear upon it for a considerably long time. The proposed Indian exchange bank was, however, to be forbidden to engage in inland business with a view to avoid competition with the Indian joint stock banks.

The proposal of the establishment of an Indian exchange bank on the initiative of the state was opposed by some people. Mr. Subedar, an important member of the committee recommended the taking up of the exchange business by a department of the Reserve Bank whose accounts

of the business were to be separate, and whose reserves were to be built up separately to meet any losses that might arise from it. He was doubtful of the Government accepting the proposal of establishing an Indian exchange bank. He was also afraid that the transfer of the business from state to private hands which was so desired in the long run could not be effected if an Indian exchange bank was to be created. On the other hand, he said that this could be brought about very easily if it was taken up by the Reserve Bank.

There was another suggestion made by the Central Banking Enquiry Committee, viz., that a bank controlled by Indians and non-Indians belonging to the countries with which India trades, as equal partners, should be established to take up this business. Foreign trade is between two parties and it was pointed out that it is opposed to the interests of both, that one of them, either Indian or non-Indian, should dominate its finances. The rupee capital of this 'joint bank' was proposed to be supplied by Indians, and foreign capital by foreigners abroad, and it was to be under joint supervision. The profits were also to be divided naturally among the partners.

Still another opinion was that the British banks doing major portion of their business in India should get themselves registered here and convert their sterling capital into rupee capital and transfer their head offices from London to India. The advantage of this transformation was considerable to the British shareholders as the banks could be thereby assured of not only retaining their business but also of making additions to it, otherwise there is a certainty of their being subjected to drastic restrictions in this country in near future and thus being crippled in their business. A necessary condition precedent to it was that of a change in the ownership of more than half of its shares from non-Indians to Indians. But whatever the consequences may be, this is certain that the scheme cannot be expected to find favour with the shareholders of these banks.

TEST QUESTIONS

1. Why is it that the foreign banks have got the monopoly of exchange business? Is there any justification for their being

called exchange banks ?

2. What part do the foreign banks play in the inland business and what influence they wield upon Indian banking system ?

3. What is the usual method in which the foreign trade of India is financed ? Describe in detail the process generally adopted in this connection.

4. What are the defects of the financing of the foreign trade of India as at present ? Explain clearly.

5. What criticisms are generally levelled against the foreign banks doing business in India ? Give your suggestions for improving the situation.

6. What is your opinion with regard to the licensing and restricting exchange banks ? Give concrete proposals. On what lines do you think such banks can reform themselves ?

7. Give your suggestions for the participation of Indians in the foreign exchange business. In this connection also please mention the various schemes laid down by different authorities.

CHAPTER XIX

RESERVE BANK OF INDIA

The Reserve Bank of India was established on April 1, 1935, in accordance with the provisions of the Reserve Bank of India Act, 1934. It is a shareholders' bank having a share capital of rupees five crores, divided into 500,000 shares of Rs. 100 each, fully paid-up. The entire share capital is owned by the public with the exception of the shares of the value of rupees two lakhs and twenty thousand which have been allotted to the Government of India for disposal at par to Directors of the Central Board of the bank seeking to obtain the minimum share qualification. They are, however, required to be resold to the Government at par on the cessation of a director from being a member. Separate registers of shareholders are kept at Bombay, Calcutta, Delhi, Madras and Rangoon, and each of them serves a separate area as defined in the schedule I to the Reserve Bank Act. The following cannot hold shares. —

(1) Those who are not domiciled in India or Burma or are not Indian or Burman subjects of His Majesty or subjects of a State in India or Burma, or

(2) those who are not British subjects ordinarily resident in India or Burma and domiciled in the United Kingdom or any part of His Majesty's Dominions the Government of which does or does not discriminate in any way against Indian or Burman subjects of His Majesty, or

(3) those companies which are not registered under the Indian Companies Act, 1913, or societies which are not registered under the Co-operative Societies Act, 1912, or any other law for the time being in force in British India relating to co-operative societies, or banks which are not scheduled banks, or corporations or companies which are not incorporated by an Act of Parliament or by any law for the time being in force in any part of His Majesty's Dominions, the Government of which does or does not discriminate in any way against Indian or Burman subjects

of His Majesty and having or not having a branch in British India or Burma, or

(4) companies or co-operative societies which are not registered in Burma under any law relating to companies or co-operative societies or banks which are not scheduled banks.

At a general meeting of the bank or at any election, each shareholder has one vote for each five shares subject to a maximum of ten votes. The capital of the Bank may be increased or decreased on the recommendation of the Central Board, with the previous sanction of the Governor-General-in-Council and with the approval of the Central Legislature. The annual general meetings of the shareholders are required to be held within six weeks of the date on which the annual accounts of the bank are closed. Up to the end of the year 1939, the accounts were closed at the end of December but since then they are closed at the end of June. The Central Government have fixed the maximum rate of dividend under section 47 at $3\frac{1}{2}$ per cent and since the inception of the bank, it has been maintained. The residue of the profit goes to the Government.

MANAGEMENT

The general superintendence and direction of the affairs of the business of the bank is in the hands of a central board of directors which consists of the following :—

(1) A governor and his deputy governors appointed by the Governor-General-in-Council after consideration of the recommendations of the central board,

(2) four directors nominated by the Governor-General-in-Council,

(3) eight directors elected by the shareholders on the various registers—two each for Bombay, Calcutta, and Delhi and one each for Madras and Rangoon,

(4) one Government official nominated by the Governor-General-in-Council.

Then, each area has got a local board whose functions are to advise the central board on such matters as are

generally or specially referred to them and to perform such duties as the central board delegates to them. Its constitution is as follows :—

(1) five members elected from amongst themselves by the shareholders who are registered on the register for a particular area and are qualified to vote, and

(2) not more than three members nominated by the central board from amongst the shareholders registered in the register of a particular area with a view to secure the representation of territorial or economic interests not already represented and in particular the representation of agricultural interests and the interest of co-operative banks.

Meetings of the central board are held at least six times in each year and at least once in each quarter.

DISTRIBUTION OF SHARES

The shares were at first distributed between different areas as follows :—

	Rs.
(Western) Bombay Register	... 14,000,000
(Eastern) Calcutta Register	... 14,500,000
(Northern) Delhi Register	... 11,500,000
(Southern) Madras Register	... 7,000,000
(Burma) Rangoon Register	... 3,000,000

A sort of economic justice had thus been secured by allocating increased amount of share capital to the more wealthy and important provinces. The economic importance of Bombay and Calcutta had been further secured by permitting the shares of the value of 35 lakhs to be subscribed therein if lesser applications were to be received from Delhi area. But no such thing happened as the applications from Delhi area had been received to a larger extent than was required.

An attempt was also made to allot shares to the largest number of people though in a number of not less than 5 to each. But the tendency has been since the inception for the shares to be concentrated in fewer hands. Hence, with a view to counteract it, a provision was made in 1940

in the second amendment to the Reserve Bank Act of that year that no person could, after March 26, 1940, be registered as a shareholder in respect of any additional share held by him whether in his own name or jointly with another person or persons in excess of a total nominal value of Rs. 20,000. The number of shares held in Bombay area has been increasing at the expense of those of other areas.

CRITICISM OF THE RESERVE BANK ACT

As the successful working of the bank depends on a carefully formulated plan we must at this stage scrutinise the Reserve Bank Act with a view to see if it has been wisely conceived.

1. There is no guarantee of the fact that there will be a national control over the national currency and credit policy of the bank. No doubt the broad outlines of the monetary standard, its organisation and policy are required to be formulated by the legislature which is supposed to be a representative body of the national interests but its decisions are subject to the vetoing power of the Governor-General and depend on his caprice. He is, in fact, authorised to refuse the introduction of any legislation concerning currency and exchange policy and there is every fear of his doing so if it runs counter to the pursuit of the Imperialist policy so far adopted by His Majesty's Government. The fixing of exchange rates of the rupee between 1s. 5½d. and 1s. 6½d. against popular opinion is a point of instance.

2. Though the fact that British subjects of those Dominions which discriminate against Indians have been disqualified from holding any shares of the Reserve Bank is surely a step in the right direction, it would have been still better had the permission to non-Indians to hold shares not been given at all. As scheduled banks can hold its shares, it is also possible that the foreign banks working in India may become its shareholders. But, as against this, it may be said that it has been wisely enacted that no bank officer except that of a co-operative bank can become a director of the Reserve Bank.

3. Urban co-operative banking tending to approximate to commercial banking, the joint stock banks consider the privilege given to a co-operative bank officer to become a director of the bank as utterly unjustifiable.

4. There is the restriction of the right of a shareholder to vote by a proxy except through a brother shareholder, and this is nothing but considerably wise. The principle of one vote for every five shares and ten votes as the maximum for one share-holder is also good.

5. It ought to have been mentioned in the Act that the Governor-General in making nomination to the central board will not be prejudiced by racial or communal feelings. Although the principle of securing continuity of policy is desirable, a provision ought to have been made, in the Act to the effect that at least two of the four nominated directors would be changed after every five years.

6. The currency of the country has been unnecessarily tied to the chariot wheel of sterling which has in itself no stability in value. The linking of one country's currency to another country's currency is in fact a sign of dependence of one country upon another, and hence produces an inferiority complex which ought not to be allowed to arise in any case.

7. Modern banking being in its infancy in this country, some of the provisions of the Act, a detailed study of which shall be made later on, do not conform to its requirements. These must be changed in the light of the experience gained so far and as suggested hereafter.

FUNCTIONS

The functions of the bank are two in number :—

(1) Central, and (2) General.

(1) Central

1. *The sole right to issue bank notes in British India.* Under the India and Burma (Burma Monetary Arrangements) Order, 1937, it has also the sole right to issue bank notes in Burma. It maintains a separate department called the Issue Department, the assets of which are kept distinct from those of its Banking Department. The assets of the

Issue Department consisting of gold coins and bullion, sterling securities, rupee coins (rupee notes included since July, 1940), rupee securities and trade bills. Of these, 40 per cent must consist of gold coin and bullion and sterling securities provided that the amount of gold coin and bullion is not less than Rs. 40 crores in value (to be reckoned at 8.47512 grains of fine gold per rupee). The sterling securities may consist of (a) balances held with the Bank of England, (b) bills of exchange bearing two or more good signatures and drawn on and payable at any place in the United Kingdom and with a maturity of not exceeding 90 days, and (c) the securities of the Government of the United Kingdom maturing within five years. There is a provision for a reduction in the percentage of these assets with the previous sanction of the Governor-General-in-Council for periods not exceeding 30 days in the first instance, which may, with the like sanction, be extended from time to time by periods not exceeding 15 days, on condition of the Bank's payment to the Governor-General-in-Council a tax on the amount of deficiency at the bank rate for the time being in force with an addition of one per cent per annum when the percentage of the holding of these assets is not less than $2\frac{1}{2}$ and of a further $1\frac{1}{2}$ per cent per annum in respect of every further decrease of $2\frac{1}{2}$ per cent or part of such decrease, but the tax is not in any event payable at a rate less than 6 per cent. The remainder of the assets are held in rupee coins (rupee notes included since July 1940), Government of India rupee securities of any maturity, and certain kinds of inland bills of exchange and promissory notes.

In actual practice the bank has so far maintained a much higher percentage of gold and sterling securities against its total liabilities.

2. *The right to hold the cash balances of the Scheduled Banks.* As already indicated, every scheduled bank is required to maintain with it a minimum balance equal to 5 per cent of its demand and 2 per cent of its time liabilities. This is with a view to enable it to use the reserve freely in emergencies to support the scheduled banks whenever they seek its assistance as a lender of the last resort. It is also possible for the Reserve Bank to influence the credit

policy of the scheduled banks through variations in the cash holdings by means of open market operations, i.e., the purchase and sale of Government securities or bills directly. This can be done also through its bank rate policy. But there has so far not arisen any occasion for the bank to take these steps. Its bank rate has remained unchanged at 3 per cent since November 8, 1951. As regards its loaning policy, a mention of the same has already been made in the chapter on Commercial Banks. Finally, it grants agricultural credit as well on the conditions already referred to in the chapter on Agricultural finance.

3. *The obligation to sell and purchase sterling at fixed rates with a view to maintain the external value of the rupee.* First of all, it is obliged to sell, to any person who makes a demand and pays the purchase price in legal tender currency, sterling for immediate delivery in London at a rate not below 1s. 5 $\frac{1}{2}$ d. for a rupee. Next, it is also obliged to purchase sterling at a rate not higher than 1s. 6 $\frac{1}{2}$ d. for a rupee. No person is, however, entitled to buy or sell an amount of sterling less than pounds ten thousand. It has also the obligation to meet the exchange requirements of the Government for which purpose it purchases sterling from the scheduled banks by weekly tender or at an intermediate tap rate.

The usual method followed in this respect is that tenders are invited¹ for the sale of sterling ordinarily in amounts of not less than the equivalent of rupees one lakh once a week, the date on which these are to be received and the amount to which the bank is prepared to purchase on that date being announced in the press and also in the notices exhibited at the offices of the bank at which the tenders are to be received. The purchases are made at all offices of the Banking Department of the bank as well at the branch of the Issue Department at Karachi. A tender may be made for the total amount specified in the announcement or for any portion thereof but in a multiple of £1,000

¹After the outbreak of the war, the invitation of tenders for the sale of sterling has been discontinued. The bank purchases since then sterling by accepting immediate offers.

but not for less than £7,500. The quotation is required to be expressed in pence and a fraction of a penny per rupee, such fraction being expressed in multiples of $\frac{1}{32}$ of a penny. In fact, tender forms are available at each office. On the acceptance of the tender in part or whole, if in part in multiples of £1,000 except when it is for the minimum amount, i.e., £1,500, payment of the rupee equivalent is made on the presentation of a receipt to the effect that telegraphic instructions have been given to the agents in London to pay the sterling immediately for the credit of the bank. This is done on Friday or if Friday is a holiday on such other day as may be specially notified. If any scheduled bank wishes to sell intermediate sterling, it makes the offer and the bank accepts or rejects it. In case of acceptance, the rate is communicated by the latter to the former. Offer for sales of intermediate sterling is never for amounts less than £25,000 in the case of Bombay and Calcutta, and £10,000 in the case of Delhi, Karachi, Madras and Rangoon.

4. *The right to transact Government business in India, and hold their balances free of interest.* For this purpose it has entered into separate agreement with the central government on April 5, 1935. Under this, it has undertaken to receive monies on Government account and to make payment up to the amount standing to its credit and also to carry out its exchange, remittance and other banking transactions free of any charge. At places where it has no branches or agencies, the money-transactions are carried on by the Government itself at Government treasuries and sub-treasuries numbering 1 300 approximately. It has also been entrusted with the management of the public debt and the issue of new loans, and for this it is allowed to charge half-yearly a commission at the rate of Rs. 2,000 per crore per annum on the amount of public debt at the close of the half-year for which the charge is made. It maintains currency chests of its Issue Department at its offices and branches, those of its agencies, and treasuries and sub-treasuries and keeps them supplied with sufficient notes and coins to provide currency for Government transactions and public remittances.

The debts of the Government may be long-term or short-

term. A detail of these is always published in the Annual Report on Currency and Finance, now issued by the Reserve Bank of India. There are various forms of paper in which long-term debts have been floated, and they all go by the name of Government securities.

Short-term loans are, however, issued in the form of treasury bills and are usually for a period not more than 3 months. Arrangement for their sale is made at all the offices and branches of the Banking Department of the Reserve Bank (except at Delhi), either by tender or at an intermediate tap rate. On a decision that the tenders should be called for, a press communique stating the date of the receipt of tenders, the amount and the currency of the bills offered for tender, and the date on which payment for accepted tenders will be required to be made is issued to the press for publication and is also sent to important banks, brokers and firms. The tenders contain the term of the bills applied for, the amount for which they are required and the rate which the tenderer is prepared to pay, which is expressed in rupees, annas and quarter annas for each Rs. 100 nominal of the bills applied for. Treasury bills are available in the denominations of only Rs. 25,000, Rs. 50,000, Re. 1 lakh, Rs. 5 lakhs, Rs. 10 lakhs and Rs. 50 lakhs. On a decision to sell intermediate treasury bills on tap, an announcement to this effect is ordinarily included in the communique giving the results of the tenders.

In case, accommodation for still shorter periods is required, it is available from the Reserve Bank in the form of Ways and Means Advances.

On the inauguration of the provincial autonomy on April 1, 1937, agreements were also entered into between various provincial Governments and the Reserve Bank of India. Under India and Burma Order, 1937, an agreement was entered into also between the Government of Burma and the bank. Except in certain respects, such as the restriction on inter-provincial remittances, on the total of ways and means advances, etc., these agreements are more or less similar to that entered into between the central government and the bank. Under the powers conferred on the autonomous provinces, they can now float both long-

term and short-term loans in the same way as the central government. The provincial governments are, however, under the terms of the agreements, required to maintain with the bank such minimum balances as may be agreed between them and the bank from time to time. Any deficiency in the same is met by ways and means advances. For remittance of funds between one province and another, however, it charges a commission equal to that charged by it from the co-operative banks and societies—no charge being made for the transference of money in the same province.

As a banker to the various Governments, it acts also as an adviser to them on financial matters.

5. *The obligation to perform certain subsidiary duties.* The above are the fundamental central banking functions. Besides, there are certain ancillary functions which it carries on. These include (a) the supplying of different forms of currency, (b) the extension of remittance facilities, (c) the management of the clearing house, (d) the rendering of advice on financial matters, (e) collection and distribution of banking statistics, etc.

Taking (a) the supplying of different forms of currency, first it may be said that the bank is under obligation to issue rupee coins on demand in exchange for notes and *vice versa*. Since July 1940 rupee coins include one-rupee Government of India notes as a temporary measure under the Defence of India Act. It is also under obligation to issue subsidiary coins and take them back. As all these forms of currency, *i.e.*, rupee coins including one-rupee Government of India notes and subsidiary coins are manufactured only by the Government, there is a provision for the supply of these by it to the Bank. In case the latter has a surplus of them, it can also give the same back to the former.

Coming to (b) the extension of remittance facilities, as has already been observed, it maintains currency chests of its Issue Department at its offices and branches, those of its agencies and treasuries and sub-treasuries and keeps them supplied with sufficient notes and coins to provide currency for Government transactions and public remit-

tances. Since Oct 1, 1940, it has introduced a new scheme for remittances, under which concession rates for these have been extended to the public, co-operative banks and societies, scheduled banks and certain non-scheduled banks and indigenous bankers. The rates for co-operative banks, scheduled banks and non-scheduled banks have already been given. These for indigenous bankers are the same as for non-scheduled banks, and those for the public are as follows :—

Up to Rs. 5,000				Over Rs. 5,000			
Rate		Minimum charge		Rate		Minimum charge	
per cent		Rs.	as. p.	per cent		Rs.	as. p.
1/8		0	4 0	1/16		6	4 0
	for drafts and mail transfers						
		1	0 0				
	for telegraphic transfers, telegram charges extra						

As regards (c) the management of clearing houses, it has been taken over by the bank in most centres where it has its offices and branches, the exception being in Calcutta and Cawnpore. In Calcutta, it is managed by a supervisor appointed by the General Committee of the Clearing Bank's Association, and in Cawnpore by the Imperial Bank of India. In other places also where there is no office or branch of the Reserve Bank, the work is, of course done by this institution. Though the bank is empowered to frame rules for the regulation of clearing houses, it has not found it necessary so far to frame any such rules, and all the clearing houses consequently continue to retain their previous autonomous character.

Then, there is (d) the rendering of advice on financial matters. As already observed in their respective contexts, the bank renders advice on financial matters to various Governments, scheduled and non-scheduled banks, co-operative societies and banks, and land mortgage institutions. In fact, it is prepared to render this service to any body.

Finally, there is (e) collection and diffusion of banking

statistics, etc. The bank prepares and transmits first of all to the central government a weekly account of its Issue and Banking Departments which is published by Government in the Gazette of India. Then, it publishes each week a consolidated statement of the returns received from the scheduled banks—a reference to which has already been made. Besides these, it supplies to the press from time to time communiques regarding treasury bill sales, clearing house figures, Government loans, etc. It has also now taken over from the central government, the compilation of the Annual Report on Currency and Finance, and of the Statistical Tables Relating to Banks in India. Finally, it publishes a monthly statistical summary, and its Annual Report.

2. General Banking Functions

1. The accepting of money on deposit without interest and also collection thereof.

2. The purchase, sale and rediscount of bills of exchange and promissory notes, drawn on and payable in India. These may arise (i) out of *bona fide* commercial or trade transactions, (ii) in connection with the financing of seasonal agricultural operations, or the marketing of crops, (iii) for the purpose of holding or trading in securities of the Government of India or a local government, or such securities of states in India as may be specified by the Governor-General-in-Council on the recommendation of the Central Board. In the first case the purchase, sale and rediscounting can be done if there are two or more good signatures in the instrument in question and one of which is that of a scheduled bank, in the second case, if one of these is that of a scheduled bank or of a provincial co-operative bank, and in the third case, if there is the signature of only a scheduled bank. The period of maturity in these cases should not be more than ninety days exclusive of days of grace in each case respectively.

3. (a) The purchase from and sale to scheduled banks of sterling in amounts of not less than the equivalent of one lakh of rupees ;

(b) the purchase, sale and rediscount of bills of exchange

(including treasury bills) drawn in or on any place in the United Kingdom and maturing within ninety days from the date of purchase, provided that no such purchase, sale or rediscount is made in India except with a scheduled bank; and

(c) the keeping of balances with banks in the United Kingdom.

4. The making to states in India, local authorities, scheduled banks and provincial co-operative banks of loans and advances repayable on demand or on the expiry of fixed periods not exceeding ninety days against the security of stocks, funds and trustee securities (not immovable property), gold or silver or documents of title to the same, eligible bills of exchange and promissory notes (see 2), and promissory notes of any scheduled bank or a provincial co-operative bank supported by documents of title to goods which have been transferred, assigned or pledged to any such bank as security for a cash credit or overdraft granted for *bona fide* commercial or trade transactions, or for the purpose of financing seasonal agricultural operations or marketing of crops.

5. The making to the Governor-General-in-Council and to such local governments as have the custody and management of their own provincial revenues of advances repayable in each case not later than 3 months from the date of making of the advance

6. The issue of demand drafts made payable at its own offices or agencies and the making, issue and circulation of bank post-bills.

7. The purchase and sale of government securities of the United Kingdom maturing within 10 years from the date of such purchase.

8. The purchase and sale of securities of the Government of India or of a local government of any maturity or of such securities of a local authority in British India or of such states in India as may be specified as such by the Governor-General-in-Council on the recommendation of the central board. The securities guaranteed by the above authorities with regard to the principal and interest will

also be included in this. The aggregate amount is limited at any time to the bank's share capital, reserve fund and three-fifths of the liabilities of the Banking Department in respect of deposits. The value of securities maturing after one year and of those maturing after 10 years should not exceed the capital and reserve of the bank plus in the order of mention $\frac{2}{5}$ and $\frac{1}{5}$ of deposit liabilities of the Banking Department.

9. The custody of monies, securities and other articles of value, and the collection of proceeds, whether principal, interest or dividends, of any such securities.

10. The sale and realisation of all property, whether movable or immovable, which may in any way come into the possession of the bank in satisfaction, or part satisfaction of any of its claims.

11. The acting as agent for the Secretary of State in Council, the Governor-General-in-Council or any local government or local authority or state in India for the purchase and sale of gold or silver, the purchase, sale, transfer and custody of bills of exchange, securities or shares in any company, the collection of any proceeds, whether principal, interest or dividends, of any securities of shares, the remittance of such proceeds, at the risk of the principal, by bills of exchange payable either in India or elsewhere and the management of public debt.

12. The purchase and sale of gold coin and bullion.

13. The opening of an account or the making of an agency agreement with, and the acting as agent or correspondent of, the central bank of another country or any international bank formed by various central banks and the investing of its money in the shares of the latter.

14. The borrowing of money for a period not exceeding one month and giving of security for it. This borrowing is, however, limited in India to the aggregate amount of its share capital from a scheduled bank, and outside India from a central bank (no limit as to the amount).

15. The making and issuing of bank notes as already indicated.

16. Generally, the doing of any such functions as may

be incidental to or consequential upon the exercise of its powers or the discharge of its duties.

From the above it is clear that the bank cannot deal with the public in such a way as to compete with the scheduled banks. It can do so when, in the opinion of the central board or any other authority to whom or to which its powers have been delegated, a special occasion arises making it necessary or expedient to do it for the purpose of regulating credit in the interests of Indian trade, commerce, industry and agriculture. It has also been expressly prohibited from doing certain kinds of business.

BUSINESS WHICH IT CANNOT TRANSACT

1. The bank cannot engage in trade or otherwise have a direct interest in any commercial, industrial or other undertaking. In case it acquires them in satisfaction of some claim, they must be disposed of as soon as possible.

2. It cannot purchase its own shares or the shares of any other bank or of any company, or grant loans upon the security of any such shares.

3. It cannot advance money on mortgage of, or otherwise on the security of immovable property or documents of title relating thereto, or become the owner of immovable property, except so far as it is necessary for its own business premises and residences for its officers and servants.

4. It cannot make loans or advances, or draw or accept bills payable otherwise than on demand, or allow interest on deposits or current accounts.

ACTUAL ORGANISATION

As was said at the commencement, the bank was established on April 1, 1935. No doubt, the Act creating it had received the assent of the Governor-General on March 6, 1934, but a good deal of spade work had to be done before its actual establishment. On December 10, 1934, the Governor-General-in-Council appointed the first Governor

and Deputy Governors of the Bank and 3 days later the central board of directors was formed. It may be said that the first board of directors had to be formed by the Governor-General-in-Council. Then, the shares were issued and this involved the usual preliminary work, arrangements for suitable premises for its offices and branches and for the transfer of staff from the Currency Department of the central government and the Imperial Bank were made. Agreements were also entered into between the bank and the Government and the Imperial Bank, the terms of which have already been given. Rules for the internal working, *e.g.*, general regulations of the bank, those for elections, meetings of shareholders; scheduled banks, refund of notes, expenditure and staff, were framed. On the date of its establishment, it assumed the duties of the Controller of Currency in connection with the note issue and reserves, sterling purchases, and the administration of the securities, and of the Imperial Bank in connection with the management of the various government accounts, the public debt and clearing houses. On July 4, 1935, its first bank rate was announced, and the next day the scheduled banks deposited their minimum deposits. The notes of the bank itself were, however, first issued in 1938.

The bank's head office, called the central office, is now permanently situated in Bombay except for the bulk of the secretary's section which moves between Bombay and Calcutta with the Governor. This section deals with board and committee meetings, annual general meetings, correspondence with the central government on the questions of currency and exchange, flotation of the loans and treasury bills of the various governments and their management, ways and means, advances, etc. The other sections are the chief Accountants' Section, the Agricultural Credit Department, and the Exchange Control Department, and each of these is further sub-divided into sub-sections. A mention of the sections of the Agricultural Credit Department and the activities of the Agricultural Credit Section has already been made. The banking section deals with all problems relating to the scheduled and non-scheduled banks, renders advice on banking and financial matters to banks and governments, and prepares reports on these

matters as and when required. The Statistical and Research Section, on the other hand, studies various statistics and compiles them. It also undertakes researches on various problems. There remain now the Chief Accountant's Section and the Exchange Control Department.

The Chief Accountant's Section maintains and supervises the accounts of the Issue Department. It also deals with the bank's expenditure, appeals for the refund of notes, remittance of treasure, distribution of notes and coins, and administration of the bank. The Exchange Control Department is a war time product and deals with the work relating to the control of dealings in coins, bullion, securities and foreign exchange which was delegated to the bank under the Defence of India Act.

Its other offices and branches are either the offices and the branches of the Banking Department or the branches of the Issue Department. The offices and the branches of the former are, at present, in Bombay, Calcutta, Delhi, Madras and Rangoon, and in Cawnpore, Karachi and Lahore respectively and the branches of the latter are in Bombay, Calcutta, Cawnpore, Karachi, Lahore, Madras and Rangoon. It has an office in London also since April 1936 for the management of the rupee debt of the Government of India enforced on London and of the account of the High Commissioner for India in London. The Imperial Bank of India is the bank's sole agent in all the places where it has its offices but the Reserve Bank has none. As already stated the Imperial Bank of India had more than 400 offices at the end of the year 1945. Besides, there are about 1300 Government treasuries and sub-treasuries where the bank maintains currency chests.

ACHIEVEMENTS

The bank was established with high hopes and we must at this stage, look as to whether they have, so far, been fulfilled to any extent. First of all, the monopoly of note issue was given to it with a view to enable it to have a complete control over the volume of cash and therefore credit in the country. We already know that the Imperial Bank of India had failed to do so because it had not been

given this monopoly. Control of the monetary system in any country depends upon the control of the purchasing power in it, and as in some countries notes or notes and coins which comprise their legal tender constitute the bulk of it, their controlling authority should have a monopoly of their issue. India is a country of this type. As regards the relative importance of the notes and coins, it may be said that the use of the former has been increasing and that of the latter decreasing for a few decades. Hence, it may be concluded that note currency far exceeds the coin currency at the present time in this country, and as such the authority controlling the former can control the monetary system in India. As between note currency and deposit currency also, it may be said that the former is more important, but as will be observed later, an attempt has also been made for the control of the latter. But in spite of this, the policy pursued by the Bank so far has not been in the best interests of the country. It was, fortunate enough for itself, established at a time when the depression had already passed its trough. Had the 1927 bill materialised and the Bank started working in 1928, it would, in the then prevailing climate of economic opinion in the Government of India, have shared the latter's supineness in true *laissez faire* style, looked on the thickening crisis helplessly and condemned itself. Even in 1935, economic recovery in India was very tardy, and there raged the keenest controversy, in 1936-37, with the bulk of opinion in favour of devaluation. There was a recession and pressure on the exchange in 1938 which had to be countered by sterling depletion. But the Reserve Bank gave little evidence of its awareness of all these happenings. The war-time record in respect of 'monetary stability' is too obvious to need much comment. Under cover of the fictitious backing of sterling for the currency, it acted as the conduit through which the external war-finance of Britain was transferred to India to cause inflation. It submitted to the immobilization and practical inconvertibility of the currency reserve into impotent hordes of international purchasing power, whereas every canon of central banking would emphasize the need for the greatest degree of liquidity. In connection with the reserve arrange-

it has done by laying down in its Memorandum dated the 7th December, 1938, on Discounts for and Advances to Scheduled Banks that in extending its credit to them it will take into consideration not only the nature of the security offered to it but also the general character of the investments of the applying bank, the manner in which its business as a whole is being conducted, whether for instance it offers excessively high rates of interest in order to attract deposits, whether it seeks help from the bank in normal times when funds in the money market are ample and whether it has been overtrading and extending an undue amount of credit for speculative purposes in commodities or securities or indulging in unsecured business to an excessive extent. This will, of course, go a great deal to improve the situation. But two more provisions are needed. First of all, the bank must have a power to obtain information from or enforce inspection on any of them at any time.² At present this is possible only on the willing co-operation of the banks themselves. As will be seen elsewhere, difficulty arose because of the lack of this provision in the case of Travancore National and Quilon Bank. Secondly, its influence and pressure must be extended over the non-scheduled banks as well. So far, they are outside its orbit.

The bank was also expected to bring the indigenous bankers in its fold, improve the machinery for dealing with agricultural finance and suggest methods for effecting a closer connection between agricultural enterprise and its own operations. This had been made obligatory upon it by Section 55. But as has already been observed nothing substantial has so far been done by it towards this end, except the issuing of the Preliminary and Statutory Reports.

Before the establishment of the Reserve Bank of India, there remained a very wide gap between the rates of interest in the busy and dull seasons. It has already been observed that this could not be bridged over by the Imperial Bank in spite of the fact that it had been given the power to obtain loans up to a maximum of Rs. 12 crores from the Paper Currency Department of the Government.

²As this was finally going to the Press, an ordinance giving this power to the Bank was promulgated.

assets which could be availed of by British India creditors and those which might be seized by the Native State for the payment of the local creditors. The bank insisted on the assistance being given only against assets which were segregated and clearly assigned to it. Further, there was the third reason, but this was also not reasonable. The Travancore National and Quilon Bank had withdrawn the greater part of its legal reserves with the Reserve Bank and it was pointed out that for this reason it did not deserve any help of the latter. But as against this, it may be said that so long as the T. N. and Q. Bank paid the prescribed penalty interest there was nothing wrong in it. Besides, the withdrawals were the unavoidable sequel to the refusal of the Reserve Bank to give any aid except after an enquiry. Finally, there were certain difficulties of the interpretation of the rules in the Reserve Bank Act. As already observed, the advances under them could be made on the security of bills of exchange and promissory notes maturing 90 days after the date of purchase. It was contended that the demand promissory notes which the Bank offered did not fall in the category. It was also held that the bills and promissory notes on which the Bank was authorised to grant loans could be only those in whose support the documents of title to goods had been transferred to the borrowing bank and not the goods themselves. Warehouses and consequently warehouse receipts, as we know do not exist in this country. Hence, it might be said that there is something wrong with the Act itself, as it is idle to prescribe such documents as a basis for central bank assistance which are not available at all.

During the war period, as has already been observed, the Bank acted in a way so as to transfer the external war finance of Britain to India and thus cause inflation in the country which in its turn brought much sufferings and misery to the people. Besides, it operated the dollar exchange control to the detriment of India and served as the agent for the gold profiteers of the British Empire and the U. S. A., by selling gold in this country at very high prices. The Bank, it may be said, thus acted admirably well as the executor of the orders of the Government. It failed, on the other hand, to act as an adviser to it. This is the real work

bills and hundis. No doubt, this is in accordance with the practice followed by the central banks in these days, but the conditions in this country demand a variation.' As is known to us, bills and hundis are not much in use in India, and there is a need of popularising them. In order to achieve this end, it is necessary that the bank rate of the Reserve Bank of India should be only the rate for discounting, and the rate for making advances on the basis of government securities should be different and also a bit higher than the bank rate. This will surely be a divergence from the practice followed these days in other countries, but will be in the interest of India, and hence, must be adopted as soon as possible.

When the Reserve Bank of India was established, it was thought that its bank rate would be more effective than that of the Imperial Bank because of several reasons. First of all, the scheduled banks are required to maintain a fixed percentage of their demand and time liabilities with it, failing which they are fined at a graduated rate which is higher than the bank rate. It was thought that this would restrict them from granting loans to their customers at rates lower than the bank rate, and also from allowing interest on deposits at a higher rate than it. Then, these banks can have no objection in rediscounting their customers' hundis with the Reserve Bank for there is no fear of any loss by the disclosure of their bill portfolios to one who does not compete with them. Further, the Reserve Bank has been charged with the obligation of being a lender of the last resort, and it can discharge its responsibility to that effect very efficiently because of the unification of different reserves with it and because of its sole power of issuing notes. But there is a serious defect in its constitution, *viz.*, that indigenous bankers are out of its fold. It is they who finance the monetary needs of trade, industries and commerce in this country to an appreciable extent, and hence the central bank with the object of controlling credit cannot be successful in its attempt without taking them into its fold.

The power of a central bank to control credit depends upon two factors, *viz.*, how far the money market is accus-

tomed to depend on its own funds and on funds borrowed from banks and how far banks themselves depend upon their own resources and those of the central bank. The volume of bills and hundis arising in India is very little, and credit is made available to the market by the indigenous bankers from their own resources. The banks are also not very much dependent for the creation of credit on the Reserve Bank. They are required to deposit a very low percentage of their liabilities with it and can manage it without any difficulty. Since its inauguration, conditions have been considerably easy in the money market, and the banks have not found it necessary to approach it for any accommodation. As already indicated, the time for the true test of the effectiveness of the weapons given for the control of credit is yet to arrive. But in the meantime, it may be said that the shortcomings pointed out herein must be removed.

OPEN MARKET OPERATIONS

The bank is empowered to carry on open market operations, *i.e.*, deal with the market directly when a special occasion arises making it necessary or expedient to do so for the purpose of regulating credit in the interests of Indian trade, commerce, industry and agriculture. But the necessity of doing this has not arisen so far. We must, however, examine the various provisions on this account, and see whether they have been so devised as to make these operations effective in times of need.

The extent and effectiveness of open market operations depend on the size and resources which the central bank can gather for this purpose, the quality and volume of the assets it is permitted to hold, and the capacity and organisation of the market in which they have to be carried out.

The resources at the disposal of the Reserve Bank consist of (1) capital and reserve, (2) the balances held on behalf of the Government, (3) the balances held on behalf of the scheduled banks, (4) the extent to which its machinery is used by other banks for collection of bills or transfer

of funds, and (5) the notes issued by it. As regards (1) capital and reserve, we know that they amount to Rs. 10 crores. This sum is surely very low in comparison with the business it is required to handle. The combined capital and reserve of the Imperial Bank is larger than this. There is, however, a provision for the increase of the capital, if need be, and along with it the increase in the reserve is also to be brought about. As regards (2) the balances held on behalf of the Government, they have varied from year to year, month to month and week to week. Their aggregate amount and time has an important bearing upon the open market operations. As regards (3) the balances held on behalf of the scheduled banks, they have also varied from year to year, month to month, and week to week. Usually these banks keep a much larger percentage of their deposit liabilities with the bank than they are required to keep by statute. Events have, however, proved that it may be to the immediate advantage of a bank to pay the penal interest and make defaults. But recently provisions have been made for a stricter penalty and now the bank can forbid a defaulting bank the receipt of further deposits for the period of default. As regards (4) the extent to which its machinery is used by other banks for collection of bills or transfer of funds, the Reserve Bank has been charged with their development and as has already been observed, it has chalked out a scheme with regard to the latter, and is providing facilities accordingly. But there is still the question of the development of bill habit. Telegraphic transfers form the bulk of the remittances, and demand drafts are quite insignificant. In fact, it is through the use of demand drafts than through the use of the telegraphic transfers that remittances increase the resources of a bank to any appreciable extent, and hence these operations do not mean at present any appreciable acquisition of funds. Coming to (5) the notes issued by it, it may be said that elasticity has been provided to a far greater extent in the present constitution of the reserve than it had been at any time.

The assets which the bank may acquire are (1) government securities of the United Kingdom maturing within 10 years from the date of acquisition without limitation of amount, and (2) securities issued by the Government of

India or a provincial government of any maturity or such securities issued or guaranteed by a local authority or by Indian State of the aggregate value of the capital and reserve of the bank plus $\frac{3}{4}$ of the deposit liabilities. Of the latter, the value of those maturing after one year and of those maturing after ten years cannot exceed the capital and reserve of the bank plus in the order of mention $\frac{2}{3}$ and $\frac{1}{3}$ of deposit liabilities of the Banking Department.

From the above, it is obvious that the maximum allotted to the longer dated securities is smaller than the maximum allotted to the securities of one to 10 years; short-dated securities are, in fact, less subject to fluctuations and thus maintain a greater liquidity.

Any change in the volume of currency can be brought about to the extent of the securities held by the bank and available in the market. Since the present war, inflation in currency is being brought about only because both sterling and rupee securities are available. Similarly deflation shall be brought about by disposing them of in the open market.

Let us now examine the capacity and organisation of the market in which dealings are to be ultimately carried out. The only stock exchanges of any importance in this country are those of Bombay and Calcutta. Their total membership is, however, very small in comparison with those of the London and New York stock exchanges and hence any dealings in them cannot but have serious consequences for the whole financial and investment mechanism. But as a considerable portion of the assets of the bank is held in sterling securities which can be dealt with in foreign markets also, the difficulty can be obviated to a very great extent.

BALANCE SHEET

The balance sheet of the Reserve Bank of India is divided into that of Issue Department and the Banking Department. It is issued weekly. The following is a specimen.—

RESERVE BANK OF INDIA
Weekly Statement of Affairs
(for the week ending August 31, 1945)

ISSUE DEPARTMENT

<i>Liabilities</i>	<i>Rs. (In Thousands)</i>	<i>Assets</i>	<i>Rs. (In Thousands)</i>
Notes held in the Banking Department ...	14,57,42	A. Gold coin and bullion	
Notes in circu- lation ...	11,39,44,78	(a) Held in India	44,41,43
		(b) Held outside India	
		Sterling secu- rities ...	10,34,32,89
		Total of A ...	10,78,74,32
		B. Rupee coins Govt. of India	17,43,60
Total Notes Issued ...	11,54,02,20	Rupee secu- rities ...	57,84,28
		Internal Bills of Exchange and other commercial papers ...	
Total ...	11,54,02,20	Total ...	11,54,02,20

Ratio of total 'A' to liabilities : 93.477 per cent.

BANKING DEPARTMENT

<i>Liabilities</i>	<i>Rs. (In Thousands)</i>	<i>Assets</i>	<i>Rs. (In Thousands)</i>
Capital paid-up	5,00,00,000	Notes ...	14,57,42
Reserve Fund ...	5,00,00,000	Rupee coins ...	30,63
Deposits—		Subsidiary coins	5,37
(a) Government—		Bills Purchased and Discounted—	
(1) Central Government...	3,63,53,37	(a) Internal ...	...

<i>Liabilities</i>	Rs. (In Thousands)	<i>Assets</i>	Rs. (In Thousands)
(2) Government of Burma ...	1,29,68	(b) External ...	...
(3) Other Govern- ment a/cs ...	18,13,90	(c) Government Treasury Bills	3,92,90
(b) Banks ...	105,19,26	Balances held abroad ...	472,77,52
(c) Others ...	13,23,07	Loans and ad- vances to Go- vernments ...	...
Bills Payable ...	3,20,24	Other loans and advances ...	...
Other liabilities	7,99,92	Investments ...	24,93,40
		Other Assets ...	6,02,25
Total ...	<u>522,59,49</u>	Total ...	<u>5,22,59,49</u>

TEST QUESTIONS

1. What are the disqualifications of the share-holders of the Reserve Bank? Do you suggest any change in these provisions?

2. Write a short note on the constitution of the central and local boards of the Reserve Bank.

3. What are the points of criticism in the Reserve Bank Act and in what direction, if any, you want a change in them?

4. Describe in brief the central and commercial banking functions of the Reserve Bank. What business has it been expressly prohibited to undertake?

5. What preliminary arrangements had to be made in connection with the establishment of the Reserve Bank? Give a short account of the organisation of its offices and departments.

6. Give an estimate of what the Reserve Bank has done so far, in what direction, if any, its working should be improved?

7. Do you think that the Reserve Bank of India has been bestowed with sufficient powers to control credit? Point out in this connection the steps that you think must be taken with a view to improve the situation.

8. Make out an imaginary balance sheet of the Reserve Bank of India and explain clearly the various items contained therein.

CHAPTER XX

DEFECTS AND REMEDIES

The main theme of the previous chapters was a description of the Indian banking system as it has grown from times immemorial and exists at present. In this chapter, we shall deal with the defects and remedies.

ABSENCE OF A WELL-KNIT ORGANISED MONEY MARKET

We have already observed that the Indian money market consists of the Reserve Bank of India, the Imperial Bank of India, the Indian joint stock banks, the foreign exchange banks, the credit co-operative institutions, the land mortgage banks, the loan offices, *nidhis*, *chit* funds, and various other indigenous bankers including money-lenders. Besides, the Government of India also played a very important part in it till very recently. No doubt, its policy is shaped now by the Reserve Bank of India, but there are still its post offices which perform important banking functions. We have already looked to the facilities provided by them for saving and investment. In addition, they provide facilities for the remittance of money and its collection under what is known as the value payable parcel system.

Before the establishment of the Reserve Bank of India, there was no co-ordination amongst the above units. They suffered also from the lack of leadership. Since the establishment of the Reserve Bank of India, however, these evils have been removed but only partly. We already know that there are non-scheduled banks which work even now without being subject to any considerable control from the Reserve Bank. Then, there are the loan offices, *nidhis*, *chit* funds and various other indigenous bankers including money-lenders which are outside its control. In short, we may say that the Indian money market consists of the modern and indigenous bankers, and of these modern bankers (though not all, yet those forming important element) are subject to the control of the Reserve Bank of India, however small it may be, while the indigenous bankers act as independent units.

As regards the relation between several units, it may be said, as has already been observed in their relative contexts, that there is much left in it as well which is desired for.

Finally, suggestions have already been given for the removal of these defects. They include the linking of the indigenous bankers with the Reserve Bank, the extension of the control of the latter over non-scheduled banks, and improvement of the relation between different constituents.

ABSENCE OF A BILL MARKET

Another defect of the Indian money market is the absence of the use of bills to any appreciable extent. This is obviously due to the following causes.—

(1) Bankers in India prefer investment in Government securities. Prior to the establishment of the Reserve Bank, they were not sure whether Imperial Bank would rediscount their hundis. It had not laid down any standard, and used to refuse accommodation on the plea of the particular hundi or hundis not being up to the standard. Again, the banks themselves preferred obtaining loans from the Imperial Bank on the security of government papers over rediscounting of their hundis as the latter step meant the disclosure of the names of their clients to an institution which acted as a rival to them, and surely this they could not like. Besides, even if the Imperial Bank refused to grant loans on the security of the government papers, or they themselves did not like to approach it, these could be easily realised in the open market. No doubt, these difficulties have been removed because of the establishment of the Reserve Bank, but the old practice naturally continues. This is more so because the Reserve Bank charges the same rate for rediscounting as well as for granting accommodation on the security of government papers. As already suggested, it can bring about a change in the situation by charging a slightly higher rate for granting loans than for rediscounting. Bank rate should be applied here only to the rediscounting of hundis and not to the granting of accommodation.

Another reason for the popularity of government papers

was their better yield. This has now ceased to be so.

(2) It has been found difficult to distinguish between finance bills and trade bills in the absence of the documents of title to goods. There ought to be warehouses, and sales should be effected by means of the transfer of the warehouse receipts which may act as the evidences of the trade transactions in connection with which bills arise, and thus facilitate the distinction between trade and finance bills.

(3) The scarcity of bills is also due to wide prevalence of the system of cash credit, which is, as has been already observed, advantageous to the borrowers as well as the lending banks. Bills, however, should be preferred by both, because of its obvious advantages, and this is sure to happen as they are realised by them.

(4) Previously, bills were unpopular also due to heavy stamp duties, but as has been observed elsewhere it has for sometime past been reduced.

(5) Bills are of foreign origin, and cannot be very popular because of the use of foreign language which very few people know. Hundis have, however, been in use in India since ancient times, and are written in almost all the local languages. But there is the difficulty of its phraseology which is very complex, and difficult to be memorised. It should be simplified. They are governed by the Negotiable Instruments Act subject to the local customs and usages which differ very widely. They should now be unified and if possible legalised.

(6) Bills arising out of foreign trade transactions are mostly drawn in terms of sterling. In case, they are drawn in terms of internal currency, they will surely lead to the building up of a bill market in the country.

(7) There is a complete absence of bills accepting houses in this country on the lines of those in England. Bankers also do not act as acceptors of bills on behalf of their customers to any appreciable extent. Its development is sure to prove very useful in building up a bill market in India.

(8) Bills are also not used in this country in connection.

with the agricultural industry. Anticipatory bills, as they are called, are in very much use in America, and they can be introduced in India as well with much advantage. Co-operative godown societies may be formed, and cultivators may be encouraged to obtain advances on harvested produce by joining them and allowing them to draw usance bills on themselves (cultivators). The societies may, then, discount them with district co-operative institutions and the latter in turn with the joint stock banks or the Reserve Bank. The indigenous bankers and money-lenders may also use the bills in making advances to the cultivators in the same way as co-operative societies

ABSENCE OF CONFIDENCE IN INDIAN CURRENCY UNIT

Indians, as a rule, have no confidence in their currency unit*. As far as possible they turn their savings in bullion and landed property. There are various reasons for this. First of all, they find that the value of their currency is precarious. Rupee is inconvertible internally, and its value has been going down in terms of bullion and other commodities almost since the introduction of the British rule. Then, they find that they are held in much higher esteem by having a small landed property whatever its value may be than by having a huge bank balance or hoarded wealth. Everyone of us knows how much influence a landlord wields not only in his zamindari but also in the place he inhabits. Next, our women folk have a special attraction for ornaments, and there is an economic reason behind it. We know that a widow has no right to inherit anything except her *stridhan* which usually takes the form of ornaments. Bank balances and gilt edged and other securities belong to the male heirs except of course when they are in the personal names of the females.

ABSENCE OF CONFIDENCE IN BANKS

Absence of confidence in banks may be permanent or only at times of distress. The two must be distinguished from one another. In Western countries also there is some lack of confidence, but this is limited only to the

*The recent High Denomination Notes Demonetisation Ordinance is bound to aggravate this tendency.

times of distress. In India it is both permanent and at such times. No doubt, the known existence of safeguards against emergencies is an important element in day to day confidence, and the prevalence of day to day confidence is an important element in moderating panics. But this must be studied separately for the sake of convenience.

Lack of day to day confidence or general confidence as it is called arises because of continuous bank failures. No one year goes when they do not take place. In 1931, 18 banks; in 1932, 24 banks; in 1933, 26 banks; in 1934 30 banks; in 1935, 51 banks; in 1936, 88 banks; in 1937, 65 banks; in 1938, 73 banks; in 1939, 87 banks; in 1940, 102 banks; in 1941, 75 banks; in 1942, 48 banks and in 1943, 50 banks with an aggregate paid-up capital of Rs. 15,05,996, Rs. 8,09,172, Rs. 2,99,948, Rs. 6,22,553, Rs. 65,95,975, Rs. 4,99,972, Rs. 11,51,656, Rs. 29,99,962, Rs. 10,11,967 Rs. 11,73,985, Rs. 9,65,089, Rs. 11,96,681, and Rs. 6,28,401 respectively failed. But these should not have the same significance as in other countries with more advanced banking systems or stricter banking or company laws. Till the amendment of the Indian Companies Act in 1936, no definition had been given of the word 'bank' with a view to ensure that only responsible concerns used this title. The result was that many insignificant or doubtful concerns registered themselves as banks, and when they failed, the number of the bank failures was swelled. Since then, a definition has been given, and banking concerns are allowed to commence business only when they have a minimum paid-up capital of Rs. 50,000 each. Besides, they are required to accumulate a like sum in the form of reserve fund. But the old concerns have been allowed to work with a paid-up capital of less than the minimum prescribed, and a close scrutiny tells us that most of the concerns which have failed in recent years belonged to this class. As time goes on, it is sure that the number of bank failures shall be lessened. There are two more points in this connection which must be noted. One of them is that failures have tended to be concentrated on banks which were more or less young. Ordinarily the long life of a concern is by itself a proof of its good management. The

second is that quite a good number of the failures has been confined to banks with small paid-up capitals, and now that it is envisaged that they will have an aggregate paid up capital and reserve fund of not less than Rs. 1 lakh each in due course, it may be hoped that there will not be many failures in future.

We shall now endeavour to take up the causes of bank failures in the past with a view to suggest remedies for the improvement of the position.

First of all, a good number of failures has been due to the lax laws, public ignorance and bad or dishonest management. Amongst the victims of this shortcoming may be mentioned, Poona Bank, Poona, Amritsar National Bank, Amritsar; Hindustan Bank, Multan; Sivarama Ayyer Bank, Madras, Pioneer Bank, Bombay; and Credit Bank of India, Bombay, which were liquidated in 1924, 1923, 1914, 1932, 1916, and 1913 respectively. The manager of the Credit Bank of India, on his appointment to the said post, pleaded ignorance of banking and accountancy and requested the Directors for a strong committee to assist him. Even up to the time of the liquidation, he had not learnt anything, as he himself had then admitted.

This shortcoming can be removed by legislation, the desire for which in this country arose after the crisis of 1913-14. It has, however, been fulfilled only very recently and that too partly² by the Indian Companies Amendment Act of 1936. Its object has been amongst other things, the protection of public against ignorance or dishonesty of the bank promoters and managers. It holds directors and officers (including auditors) criminally liable for false statements under certain conditions. There is a civil liability as well over them for misapplication or retaining of money, and misfeasance or breach of trust which includes breach of duty as well, both as an act of commission or omission. There is a provision of penalising for falsification of books, etc., also.

² In a letter dated the 1st November, 1939, the Reserve Bank of India has submitted a draft bill to the Government for a separate Indian Bank Act, Please consult appendix C.

Secondly, many of them have failed because of their undertaking industrial finance out of banking funds. Amongst those victims of it may be mentioned the names of the Peoples Bank, Lahore; Amritsar Bank, Lahore; and Tata Industrial Bank which failed in 1913, 1914 and 1923 respectively. In fact, public opinion in India has been overwhelmingly in favour of mixed banking such as prevails in Germany and Japan. But this is not possible here due to the fact that the Indian banking system has been based more on the lines of the English banking system whose characteristic feature is the complete separation of commercial banking from industrial banking.

Thirdly, many banks have failed because of the entering into speculative activities of the bank officers. While some of the banks, already referred to, failed on this account as well, the most glaring example is that of the Indian Specie Bank which failed in 1914. Rumours had been current since the earliest years of its career that the bank had embarked on colossal speculative activities. But they had always been denied and concealed. Mr. Chunilal Saraiya, the managing director of the bank, whose name had always been associated with it was a man of remarkable qualities. He was very skilful in window-dressing, and managed to show a good balance sheet at the close of every year. At last an insignificant share-holder alleged to have been instigated by the personal enemies of this gentleman presented a petition to the High Court for its winding up. But this was challenged by the share-holders and directors, and everything went on quite all right. Suddenly, however, Mr Chunilal Saraiya died of heart-failure, and the remaining directors themselves rushed to the High Court with a petition for voluntary liquidation. The inevitable examination proved the allegation to be quite correct.

Fourthly and finally, many of the banks have failed because of the antagonistic mass opinion against them which had developed at one time or the other. They may be regarded more as victims of misfortune than of anything else. First of all, there is the Bank of Upper India which had been registered at Meerut in 1863. It went on making continuous progress till 1914 in which year it sud-

denly failed. Both the depositors and the share-holders were paid in full. Then, there is the Alliance Bank of Simla. Being established in 1874, it carried on its business successfully till 1923 when it crashed. It fell on evil days largely on account of the losses it had to suffer due to the failure of its London Agents, Boulton Bros. to return a deposit of Rs. 150 lakhs which they held from it. Another debtor to the bank as well, namely the Trust of India, Punjab was not in a good position. In their report for 1922, the directors spoke plainly of it, but assured to do whatever they could. There were, however, continued withdrawals and ultimately it crashed. The name of one more bank namely the Travancore National and Quilon Bank may also be mentioned in this connection. It suspended its payment very recently *i.e.*, in 1938. This institution, as it stood on the date of suspension, was the outcome of an amalgamation between the Travancore National Bank and the Quilon Bank, which had taken place only two years before this event. The previous history of these concerns had been quite remarkable. The failure of the institution after the establishment of the Reserve Bank whose member it was, is really very discouraging. The causes of the inability of the Reserve Bank to help it have already been dealt with.

This brings us again to the causes of the lack of day to day or general confidence in banks. In addition to that of the continuous bank failures, there are several others. Absence of comprehensive banking laws inspiring confidence in the general banking system may be mentioned as the next. These contribute to public confidence in different ways. First of all, they strive to ensure sound management, and at least immunity from more flagrant abuse of place and power. What has been done in this respect recently by the passing of the Indian Companies Amendment Act, 1936, has already been said. Secondly, they strive to give wider and better publicity of accounts. The Indian Company Law has always adhered to one general form of balance sheet to which all companies are expected to conform. In the case of banks, however, certain special provisions are required to be observed. But this is entirely unsatisfactory and the construction of a

examination. The Finance Member, at first, said that it was done with a view to continue favourable conditions in the English and Indian money markets for facilitating Government borrowings and good effect which the balancing of the budget had created. But this was too large a proposition to hang on the outstanding current and fixed deposits of the bank which amounted to only Rs. 7 crores, and perhaps realising it he subsequently said that the step was most desirable in the interests of Indian finance and Indian banking and calculated to restore public confidence and prevent causing inconvenience and probably danger to other sound institutions, and thus widened the future responsibilities of the Government though unconsciously. The people of this country, however, thought otherwise. They believed that this was done because the Alliance's clientele consisted of largely officials and Europeans, whose interests the Government was bound to safeguard. The next opportunity to test the motive, however, arose in 1938, when a similar contingency occurred on the failure of the Travancore National and Quilon Bank, but at this time, nothing of this sort was done by the central government. It may, no doubt, be pointed out that the situation had much changed by that time. The powers of the provincial governments had been widened, and hence the responsibility in this respect too had shifted to their shoulders. The attitude of the Madras Government was, in fact, commendable. Most of the branches of the T. N. & Q. Bank being located in area under its authority, it was but natural that it should have acted promptly. Consultations with the Reserve Bank of India had been made by it even when the bank in question seemed to be in distress, and as a result the latter had been advised to agree to immediate and thorough investigation. But as has already been observed it was too late to mend. Later on, the Prime Minister made an appeal to the public to remain calm and refuse to be rushed by ill-founded rumours. In addition, he informed them that steps were being taken to secure an immediate examination of the accounts and affairs of the banks in Madras. Two months after this he assured them that the scheduled banks in that presidency were in a perfectly sound position, and even those which had taken

help from the Reserve Bank had cleared off all their accounts, and that the latter was prepared to help them again should such an occasion arise in near future. This was really very significant. But in cases, where the branches of the bank in distress are spread all over the country and the panic is not confined to a particular locality, it is the central government which will be required to act and not the provincial governments. The latter cannot be very effective.

Next, the central bank can improve the situation. About the extent of its success or otherwise we have already discussed. Formerly there was an absence of such an institution in this country. The gap has, however, been filled up by the establishment of the Reserve Bank. But as has been pointed out in the previous chapter, it failed completely to rise to the occasion during the single instance which provided a test for its usefulness in this respect. Let us, however, hope that it will acquit itself more admirably in future.

Thirdly, the press and public opinion also wield much influence. The part played by them in the United Kingdom during the crisis of 1931 in creating a calm confidence in the British depositor by incessant patriotic propaganda cannot but be commended. On the other hand, the U. S. A. press and public opinion gave a different account when a crisis occurred in that country following upon the heels of the United Kingdom's abandonment of the gold standard. In India also, we find the same thing. Anglo-Indian and British papers have always been spreading false rumours about Indian joint stock banks. At one time, Lala Har Kishen Lal, the bank promoter of Punjab, was undoubtedly the central object of their hottest fire. Here public opinion is also apt to be easily led away against the banking institutions of the country. It has, several times, relying on the rumours floated by the enemies of the Central Bank, rushed to withdraw money from it, but thanks to the wisdom of the management that the institution has always been able to tide over the difficulties.

Finally, banks can also do a lot in this connection. They must take every precaution to forestall the causes

and moderate the effect of serious situations. This, they can do by giving wider publicity to their affairs. They may also take the depositors into their confidence by making room on the board of directors for their representative. The right to elect him may be limited to only those who maintain an average minimum balance, and the list of such persons may be subject to revision, say after two or three years.

NEGLECT OF OTHER BRANCHES OF BANKING

Indian joint stock banks have been established only with a view to take up commercial banking. Though a few attempts have been made to establish institutions to take up industrial banking as well, no large-scale success has been achieved in this respect. Co-operation has been devised with a view to solve the difficulties of agricultural finance, and the principle has not been extended to the financing of the industries. Exchange business has been sadly neglected by Indian institutions and there is a great need of their taking it up. In short, it may be said that there has been a neglect of other branches of banking than commercial and agricultural in this country.

WHOLESALE IMITATION OF ENGLISH SYSTEM

There has been a wholesale imitation of English system in the parlour of banking with the result that the Indian ideal of simplicity in all spheres of life has been jettisoned in this sphere. The disadvantages arising from this characteristic have already been dealt with. It has, in fact, failed to penetrate in the heart of the country only on this account

USE OF FOREIGN LANGUAGE

Banks in this country use English language. We already know that many of our people are not even literate what to say of their being conversant with English. Under the circumstances, they find it very difficult to deal with them. The use of the English language necessitates the appointment of the English knowing people, and their number being very small, the scope for selection is very much narrowed.

FOREIGN DOMINATION

The Indian banking system is dominated by non-Indians whose real sympathies and interests cannot be with India. Their only aim is to earn profit and exploit the people of this country. They have, in fact, failed to inspire confidence and solve Indian problems. Further, they have not been successful to establish a closer relation with the people which is very necessary from all points of view.

LOW LEVEL OF INCOME OF THE PEOPLE

Banking suffers in this country also because of the low level of income of the people. No other single cause is perhaps more responsible for the slow growth of the banking habit than our general poverty. Figures of the people paying income-tax and the average size of the incomes, the number of depositors and the average deposit per head, etc., testify to the narrow field over which banking has to traverse here. Many people, high in educational or social status, have to forego the pride and convenience of having a bank account only because of their inability to maintain a minimum balance in it. It may be said that the banks on their part are to be blamed for prescribing such conditions for opening accounts or minimum average balances for giving certain facilities as are difficult to observe or maintain. But, it should not be lost sight of that this is done after taking into consideration certain well-known principles, and their violation is not desirable from several points of view. In prescribing certain conditions for opening an account, banks aim at certain financial status in their customers, and in stipulating the maintenance of a certain minimum average balance, they aim at securing payment for the cost of rendering free services.

LACK OF TRAINING IN BANKING

Trained Indians in both theory and practice of banking are not available. Until the end of the nineteenth century, commercial and banking education had been completely non-existent in this country. For a few decades arrangements have, however, been made for it, but advantage is not being taken of the facility so far provided to

any appreciable extent. It will be done only when a sort of co-ordination is attained between the universities and the banks in the country.

ABSENCE OF BANKING LAW

There is no separate banking law in India. The Indian Joint Stock Companies Act applies to it as well. No doubt, it contains now much more elaborate provisions than before, but this is not sufficient. Proposals* have, however, been made by the Reserve Bank of India to remedy the evil, and they are before the Indian Legislatures now. It is hoped that an Indian Bank Act will be passed soon.

ABSENCE OF A BANKERS' ASSOCIATION

A Bankers' Association is of necessity in this country. Its usual aims are creation of good relations amongst different members, provision of a common meeting place for them to assemble and discuss their common topics, elimination of competition and rivalry, education of banking staff by arranging lectures and classes, maintaining of libraries and reading rooms, and issuing of banking literature in the form of magazines, handbills, and other periodicals. In Western countries, they have introduced better methods of doing business and succeeded in raising the morals of the people. Their usefulness in allaying panic can also not be disputed, and the need for their establishment is the greatest in this country for this reason if not for others.

TEST QUESTIONS

1. What are the defects from which Indian banking system as a whole suffers? Suggest measures to improve the situation.
2. What are the causes of the unpopularity of bills in India? Suggest measures to make them popular.
3. What have been the causes responsible for the bank failures in this country? Do you think that the situation has now been improved in any way?
4. Give your suggestions for inspiring public confidence in

*See Appendix 'C.'

the banking system of the country. Has anything been done so far in this connection ?

APPENDIX A

DEFINITION OF A BANKING COMPANY

Section 277F of Indian Companies Act (1936)

A 'banking company' means a company which carries on as its principal business the accepting of deposits of money on current account or otherwise, subject to withdrawal by cheque, draft or order, notwithstanding that it engages in addition in any one or more of the following forms of business, namely :

(1) the borrowing, raising or taking up of money ; the lending or advancing of money either upon or without securing ; the drawing, making, accepting, discounting, buying, selling, collecting and dealing in bills of exchange, hundis, promissory notes, coupons, drafts, bills of lading, railway receipts, warrants, debentures, certificates, scrips and other instruments, and securities whether transferable or negotiable or not ; the granting and issuing of letters of credit, travellers cheques and circular notes, the buying, selling and dealing in bullion and specie ; the buying and selling of foreign exchange including foreign bank notes ; the acquiring, holding, issuing on commission, underwriting, dealing in stock, funds, shares, debentures, debenture stock bonds, obligations, securities and investment of all kinds ; the purchasing and sellings of bonds, scrips or other forms of securities on behalf of constituents or others ; the negotiating of loans and advances, the receiving of all kinds of bonds, scrips or valuables on deposits or for safe custody or otherwise, the collecting and transmitting of money and securities ;

(2) acting as agents for governments or local authorities or for any other person or persons ; the carrying on of agency business of any description other than the business of a managing agent, including the power to act as attorneys and to give discharges and receipts ;

(3) contracting for public and private loans negotiating and issuing the same ;

(4) the promoting, effecting, insuring, guaranteeing, underwriting, participating in managing and carrying out of any issue, public or private, of State, Municipal or other loans of shares, stock, debentures, or debenture stocks of any company, corporation or association and the lending of money for the purpose of any such issue ;

(5) carrying on and transacting every kind of guarantee and indemnity business ;

(6) promoting or financing or assisting in promoting or financing any business undertaking or industry, either existing or new, and developing or forming the same either through the instrumentality of syndicates or otherwise ;

(7) acquisition by purchase, lease, exchange, hire or otherwise of any property immovable or movable and any rights or privileges which the company may think necessary or convenient to acquire or the acquisition of which in the opinion of the company is likely to facilitate the realisation of any securities held by the company or to prevent or diminish any apprehended loss or liability ;

(8) managing, selling and realizing all property movable and immovable which may come into the possession of the company in satisfaction or part satisfaction of any of its claims ,

(9) acquiring and holding and generally dealing with any property movable or immovable which may form part of the security for any loans or advance or which may be connected with any such security ;

(10) undertaking and executing trusts ;

(11) undertaking the administration of states as executor, trustee or otherwise ;

(12) taking or otherwise acquiring and holding shares in any other company having objects similar to those of the company ;

(13) establishing and supporting or aiding in the establishment and support of associations, institutions, funds, trusts and conveniences calculated to benefit employees of the company or the dependents or connexions of such persons, granting pensions and allowances and making pay-

ments towards insurance; subscribing to or guaranteeing moneys for charitable or benevolent objects or for any exhibition or for any public, general or useful object;

(11) the acquisition, construction, maintenance and alteration of any building or works necessary or convenient for the purposes of the company;

(15) selling, improving, managing, developing, exchanging, leasing, mortgaging, disposing of or turning into account or otherwise dealing with all or any part of the property and rights of the company;

(16) acquiring and undertaking the whole or any part of the business of any person or company, when such business is of a nature enumerated or described in this section;

(17) doing all such other things as are incidental or conducive to the promotion or advancement of the business of the company.

APPENDIX B

DRAFT SCHEME FOR THE LINKING OF INDIGENOUS BANKERS

The Reserve Bank of India addressed in May, 1937 to the Scheduled Banks and Shroffs' Association a letter containing the following conditions which must be fulfilled by the indigenous bankers wishing to be linked directly with it:—

(i) They must confine their business to banking proper as defined by the Indian Companies Act. Any other business that they might be conducting should be wound up within a reasonable time.

(ii) They must maintain proper books of account, and have them audited by registered accountants. The Reserve Bank will have the right to inspect the accounts and call for any information necessary to determine the financial status of the banker.

(iii) They must file with the Reserve Bank the periodical statements prescribed for scheduled banks. They must also, in the interests of their depositors, publish the returns prescribed for banking companies by the Companies Act and be liable to the same penalties for non-compliance.

(iv) The Reserve Bank will have the right of regulating the business of the bankers on banking lines, when necessary.

(v) During a period of five years from the date of their registration as private bankers in the books of the Reserve Bank, they will be entitled to open an account at any of the offices of the Reserve Bank, and be otherwise subject to the same conditions as the scheduled banks except that during such period they will not be required to furnish the compulsory deposit set out in section 42 of the Reserve Bank Act, unless any of their weekly statements discloses that their demand and time liabilities are five times more in excess of their capital in the business.

(vi) If an indigenous banker does not incorporate himself under the Companies Act, his liabilities in respect of his banking commitments will be unlimited. He should, therefore, state the amount of capital he has available for banking business. (Bankers with a capital of less than two lakhs need not apply.)

(vii) When required they will have to indicate—

(a) The names and the extent of interest of their business partners if any ; and

(b) If any of the bankers is a member of a Hindu joint family, the names and interests of the co-sharers. In both the cases statements will be required from the co-sharers and that they are prepared to take their full share in the business and its liabilities.

(viii) This scheme will be a tentative one for a term of five years, but before the end of this period the Reserve Bank will frame proposals for legislation, if it thinks fit, further to co-ordinate or regulate the position of the private bankers. It is likely that such legislation would take the form of a separate Bank Act as suggested by the Banking Enquiry Committee or otherwise to standardise and co-ordinate the status of these registered private bankers on lines in consonance with the scheduled banks.

(ix) (1) If they satisfy the above conditions, they will have the privilege of rediscount with the Reserve Bank against eligible papers, the right to secure advances against government paper, and remittance facilities similar to those for scheduled banks.

(2) If the Reserve Bank decides to take action on the

lines here indicated, legislation will be necessary and the indigenous bankers will then be called upon to make an application in the manner which may then be prescribed.

APPENDIX C*

PROPOSALS FOR AN INDIAN BANK ACT.

The following are the main features of the proposals contained in the Bank Bill now before the Central Assembly :—

(1) A simple definition of banking with the object of limiting the scope of the legislation to institutions in which funds are deposited primarily to ensure their safety and ready withdrawability. Clause 5 (b) of the Bill defines banking as "accepting of deposits repayable on demand." Under clause 7, every banking company must use as part of its name the words 'bank,' 'banker' or 'banking' and any company having such words as part of its name shall be deemed to be a banking company.

(2) Prohibition of trading with a view to eliminating non-banking risks. Clause 6 enumerates the forms of business in which a banking company may engage, whilst clause 8 prohibits a banking company from trading in goods or articles of merchandise. Any non-banking assets acquired by a banking company in satisfaction of its claims must be disposed of within 7 years (to be extended to 10 years with the Reserve Bank's permission) under clause 9.

(3) Prescription of minimum capital standards. Under clause 11, the following should be the minimum aggregate capital and reserves of a banking company :—

- (a) Rs. 20 lakhs if it has a place of business outside the Province or State where it has its principal office.
- (b) Rs. 5 lakhs in respect of a place of business at Bombay or Calcutta.
- (c) Rs. 2 lakhs in respect of each town having a population of 1 lakh and over where it has a place of business.

*Taken from the Journal of the Indian Institute of Bankers, January 1945 issue.

- (d) Rs. 10,000 in respect of each place of business elsewhere.

Provided that the minimum capital and reserves of a banking company shall be Rs. 1 lakh and no bank shall be required to have capital and reserves in excess of Rs. 20 lakhs. Banks in existence on the 1st January, 1945, are allowed 2 years to comply with the provisions of this section of the Act.

(4) Inclusion in the scope of legislation of banks incorporated or registered outside British India :—

- (a) A bank registered outside British India or the United Kingdom must deposit cash or approved securities with the Reserve Bank of India in lieu of capital requirements. (Clause 11(2))
- (b) A banking company incorporated outside British India or the United Kingdom must take out a licence from the Reserve Bank of India before commencing business in British India. (Clause 17.)
- (c) A banking company registered outside British India must prepare a balance sheet and profit and loss account in respect of its business in British India. (Clause 22.)

(5) Restrictions on business :—

- (a) Every banking company is required to maintain, after the expiry of two years from the commencement of the Act, in cash, gold or unencumbered approved securities, an amount of not less than 25 per cent of its total demand and time liabilities in British India and to secure compliance of this every banking company is required to submit a weekly return to the Reserve Bank of India of its liabilities at the close of *each day* of the week. (Clause 18.)
- (b) The assets in British India of every banking company should not be less than 75 per cent of its liabilities in British India on the 31st December of every year and to ensure compliance of this a return in the prescribed form has to be submitted to the Reserve Bank of India (Clause 19.)
- (c) A banking company shall not hold shares in any

company whether as a pledgee, mortgagee or absolute owner of an amount exceeding 40 per cent of the issued and subscribed capital of that company. (Clause 15 (2).)

- (d) No bank shall make advances on the security of its own shares or grant unsecured advances to its directors or to firms or companies in which it or any of its directors is interested as partner, director or managing agent. (Clause 16.)

(6) Inspection of the books and accounts of a bank by the Reserve Bank of India when 'necessary and empowering the Central Government to take action against banks conducting their affairs in a manner detrimental to the interests of the depositors :—

- (a) Under clause 28, the Central Government may direct the Reserve Bank of India to inspect a bank and report thereon, if it has any reason to believe that the interests of the depositors are in danger or that the bank is unable to meet its obligations or has made default in complying with any of the provisions of the Act or that an offence under the Act is likely to be committed or action is otherwise desirable or necessary.

- (b) The Government may on receipt of the report, (1) prohibit a bank from receiving fresh deposits, (2) exclude it from the Second Schedule to the Reserve Bank of India Act, or (3) direct the Reserve Bank of India to apply to the Court for winding-up the bank.

(7) Provision of an expeditious procedure for liquidation :—

- (a) An application to the Court for suspension of business by a bank which is temporarily unable to meet its obligations must be accompanied by the report of the Reserve Bank of India that the applicant bank will be able to pay its debts and the period of suspension shall not exceed 3 months in all. (Clause 30.)

- (b) Under Clause 31, the Court shall order the winding-up of a banking company if it is unable to pay its debts or if the Reserve Bank of India applies to the Court in this behalf on the grounds that the affairs

of the company are being conducted to the detriment of the interests of depositors as revealed by inspection or that the company has failed to maintain the required percentages of assets under clauses 18 and 19. A bank is unable to pay its debts according to clause 31 (2) if it has refused to meet any lawful demand made at any of its offices or branches within 2 working days if such demand is made at a place where there is an office, branch or agency of the Reserve Bank of India or within 4 working days if such demand is made elsewhere.

- (c) Sections 32 to 36 provide for the appointment of the Reserve Bank of India as official liquidator of a banking company, for the power of the Court to dispense with meetings of creditors, and for accepting the amounts standing in the books of a bank to the credit of depositors without further proof. Section 37 requires that no bank shall be *voluntarily* wound up unless the Reserve Bank of India certifies in writing that the bank is able to pay in full all its debts as they accrue.

(8) Prescription of a special form of balance sheet and conferring powers on the Reserve Bank of India to call for periodical returns—a special form of balance sheet and profit and loss account is prescribed for banking companies. (Clause 22). It is an improvement on the existing Form F and requires, *inter alia*, assets and liabilities in British India and outside British India to be shown separately. In addition every banking company is required to submit to the Reserve Bank of India a monthly statement of its assets and liabilities in British India; the Reserve Bank of India may call for half-yearly statements regarding the classification of advances and investments. (Clause 20). Every banking company is also required to submit at the end of each calendar year a return of deposits unclaimed for 10 years. (Clause 21) The cash reserve returns, submitted by non-scheduled banks at present under section 277L of the Indian Companies Act, to the Registrars of Companies, are required to be submitted to the Reserve Bank of India. (Clause 14).